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**OIL IMPORT FEE: ITS ENERGY POLICY IMPLICATIONS
AND CONSUMER IMPACTS**

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HEARING
BEFORE A
SUBCOMMITTEE OF THE
COMMITTEE ON
GOVERNMENT OPERATIONS
HOUSE OF REPRESENTATIVES
NINETY-SEVENTH CONGRESS
SECOND SESSION

APRIL 27, 1982

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CONTENTS

Hearing held on April 27, 1982	Page 1
Statement of—	
Blum, Jack, general counsel, Independent Gasoline Marketers Council	166
Buckley, John G., board of directors, the New England Council, Inc	155
Chisholm, Philip R., executive vice president, National Oil Jobbers Council	168
Conte, Hon. Silvio O., a Representative in Congress from the State of Massachusetts	2
Cooper, Dr. Mark, director of research, Consumer Energy Council of America	10
Moffett, Hon. Toby, a Representative in Congress from the State of Connecticut, and chairman, Environment, Energy, and Natural Resources Subcommittee: Opening statement	1
Montgomery, W. David, senior fellow, Resources for the Future, accompanied by Douglas R. Bohi, senior fellow, and Harry G. Broadman, fellow	56
Sweeney, Steve J., senior vice president, Boston Edison Co	68
Van Arsdall, R. Thomas, vice president, energy resources, National Council of Farmer Cooperatives	175
Letters, statements, etc., submitted for the record by—	
Bohi, Douglas R., senior fellow, Resources for the Future: Prepared statement	60-67
Broadman, Harry G., fellow, Resources for the Future: Prepared statement	60-67
Buckley, John G., board of directors, the New England Council, Inc.: Prepared statement	157-165
Chisholm, Philip R., executive vice president, National Oil Jobbers Council: Prepared statement	170-174
Conte, Hon. Silvio O., a Representative in Congress from the State of Massachusetts: April 14, 1982, letter from James B. Edwards, Secretary of Energy, concerning oil import fee	5
Cooper, Dr. Mark, director of research, Consumer Energy Council of America: Prepared statement and council overview	14-55
Dennison, Ray, director, department of legislation, AFL-CIO: Prepared statement	151-152
Kennelly, Hon. Barbara B., a Representative in Congress from the State of Connecticut: Prepared statement	8-9
Moffett, Hon. Toby, a Representative in Congress from the State of Connecticut, and chairman, Environment, Energy, and Natural Resources Subcommittee:	
April 27, 1982, letter from the Air Transport Association of America on oil import fees	153-154
Library of Congress study by Bernard A. Gelb entitled "Revenue and Macroeconomic Impacts of an Oil Import Tax: A Brief Review"	107-126
Library of Congress study by Larry Kumins entitled "Background on Oil Import Fee Proposals: Some Policy and Economic Considerations"	95-106
Petroleum Industry Research Foundation, Inc., study entitled "The Oil Import Fee Issue"	129-145
Study entitled "An Exegesis on New Oil Taxes"	79-94
Montgomery, W. David, senior fellow, Resources for the Future: Prepared statement	60-67
Sweeney, Steve J., senior vice president, Boston Edison Co.: Prepared statement	70-73

IV

Letters, statements, etc., submitted for the record by—Continued	Page
Van Arsdall, R. Thomas, vice president, energy resources, National Council of Farmer Cooperatives: Prepared statement.....	178-183

APPENDIX

Statement submitted for the record.....	189
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OIL IMPORT FEE: ITS ENERGY POLICY IMPLICATIONS AND CONSUMER IMPACTS

TUESDAY, APRIL 27, 1982

**HOUSE OF REPRESENTATIVES,
ENVIRONMENT, ENERGY,
AND NATURAL RESOURCES SUBCOMMITTEE
OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
Washington, D.C.**

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 2203, Rayburn House Office Building, Hon. Toby Moffett (chairman of the subcommittee) presiding.

Present: Representatives Toby Moffett, Mike Synar, Barney Frank, John Hiler, and Judd Gregg.

Also present: Cathy Hurwit, professional staff member, and Becky Meadows, staff assistant.

OPENING STATEMENT OF CHAIRMAN MOFFETT

Mr. MOFFETT. The subcommittee will please come to order.

In recent weeks, the oil import fee has been considered by the administration and budget negotiators as a means for reducing the unprecedented \$182 billion deficit now projected for next year.

It is ironic that those who attempted to persuade the administration of the national security benefits of the fee now find their arguments overshadowed by the current rush for revenues. It is even more ironic that many recent converts to the fee, such as OMB Director David Stockman, had earlier rejected those arguments and opposed imposition of the fee because of the economic repercussions.

This subcommittee, which conducted an indepth investigation of the import fee proposed by President Carter, believes that all national security, economic and consumer impacts of raising energy prices, should be thoroughly studied before any fee is adopted.

Preliminary studies show clearly that consumers will bear the burden of increased gasoline and heating oil prices. We should be very cautious, therefore, before taking such a regressive measure and, above all, such a decision should not be reached without a full public debate.

Studies have already revealed that the \$5-per-barrel import fee being discussed would have significant negative economic impacts beyond the effect on individual consumers. Most experts predict the inflation rate would rise by a percentage point, while the real GNP would fall by an equivalent amount. Nonenergy industries, especially energy-intensive ones such as petrochemicals, steel, and

textiles, would have profits reduced as costs rise and would be put at a competitive disadvantage in international markets.

As consumers and businesses spend more on energy, savings would drop, making less capital available and tightening interest rates. The regional and individual inequities of a revenue-raising tax on oil are evident. My State of Connecticut and the whole New England area would bear a disproportionate share of the tax burden from an import fee.

In short, all the economic benefits recently obtained by stable energy prices would vanish. Energy users buffeted by cartel-set prices would once again be caught in a price squeeze, this time at the initiative of their own Government.

At the same time, however, I am in agreement with those who are disturbed over this administration's apparent unconcern over import dependence and the potential reemergence of OPEC. Those who raise this are doing the Nation a service by attempting to focus debate on the problem of our import vulnerability. We badly need a sound strategy to reduce that vulnerability before the next oil cutoff.

Yet, an import fee is an extremely expensive form of import reduction. With an estimated 250,000-barrel-a-day saving and a total cost of \$28 billion, the cost is over \$300 per barrel saved. Direct expenditures on conservation would be more cost efficient, while oil proliferation strategies and emergency planning would be more effective in terms of reducing our vulnerability to import disruptions.

The projected deficit in the administration's budget must be reduced. But the budget should not be balanced on the backs of consumers and the budget certainly should not be balanced by measures that mortgage our economic future by slowing our depressed economy, reducing our international competitiveness, and doing little to limit our dependence on foreign oil.

To begin our analysis of this issue, we have with us a colleague who has been a leader in this area in pointing out the liabilities that would come with an oil import fee. For those of us in the Northeast and in New England, he has been certainly a champion of our particular point of view in terms of how an oil import fee would affect our region.

It is the Chair's pleasure to welcome to the subcommittee our colleague, Hon. Silvio Conte.

STATEMENT OF HON. SILVIO O. CONTE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MASSACHUSETTS

Mr. CONTE. Thank you, Mr. Chairman.

Mr. MOFFETT. Without objection, your full statement will be included in the record.

Mr. CONTE. Thank you, Congressman Moffett.

It is an honor for me to appear before this august subcommittee on which you so ably serve as its chairman. Your diligence and your relentless efforts on this issue are of critical importance to this country and are to be applauded.

I am pleased to see my two good friends, Mr. Hiler and Mr. Gregg from the great State of New Hampshire here. Mr. Hiler not only serves on my Subcommittee on Small Business, but he ably

serves on a championship baseball team which I have the privilege of coaching.

Mr. Gregg is a freshman from New Hampshire, filling the great shoes of our good buddy, Jim Cleveland, and doing an outstanding job for his constituents.

As you know, I am the sponsor of House Resolution 430 which expresses the opposition of the House of Representatives to the imposition of an import fee on crude oil and refined petroleum products by either the President or the Congress.

My motives for introducing such a piece of legislation in 1982 are the same as they were in 1959 when I vehemently opposed an Eisenhower administration import proposal which would have had a similar impact upon the consumers of this Nation.

However, in 1982 I can report to you that we have a very, very important ally in the administration, the Secretary of Energy, Jim Edwards. In response to a letter that I wrote to the editor on this issue of the New York Times newspaper, Secretary Edwards wrote to me on April 14 and stated:

Our past experience with quotas, taxes, price controls, entitlements, have taught us at the very least that we must make every effort to avoid such a course.

My only hope is that those advisers in the administration and the Members of Congress who profess to support regulatory reform heed his words.

Now as the administration and the Congress contemplate the details of the budget proposal, discussion regarding a quick fix solution to raise revenue persists. As you and I are keenly aware, one such proposal which has reared its ugly head more than once is the oil import fee. It is without question the most ill conceived, regressive proposal before the current host of budget balancers who are playing revenue-raising roulette. In fact, whatever precious social security benefits are retained will ultimately be eaten up as a result of dramatically higher prices for necessities such as food, housing, electricity, home heating oil, and transportation.

Lest anyone characterize our efforts to oppose the fee as an attempt by the Northeast to avoid paying for its energy needs, I suggest that they consider the results of a study prepared by CRS on the dire impact of such a \$5 fee on the entire economy.

The bottom line is that the effect of such a fee will cause a ripple effect throughout all the sectors of the ailing economy. No family in this country will be spared the adverse impact of the fee as the price of domestically produced crude oil raises to the level of the artificially priced imports.

The price of home heating oil, gasoline, and diesel fuel will increase by 12 cents a gallon. Residents in some sections of our country, which depend heavily upon electricity as their source of energy, will witness an increase in their utility bills of nearly \$100 a month.

The residual effect of a \$5-per-barrel tax is ominous. Not only will the price of all petroleum products increase by 10 to 15 percent, but so, too, will the ailing housing, automobile, transportation, and agricultural industries feel the devastating impact.

The list of affected industries is endless. None will be spared. And you pointed out what will happen to the chemical industry

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who is exporting a great amount of chemicals to Europe, who will be put at a competitive disadvantage.

By now I am sure that many members have read the studies available of this critical issue. CRS report estimates a \$5-per-barrel fee will cause unemployment to climb by another 96,000 workers in 1984; the real GNP to decline by another 1.4 percent; and housing starts to decline by another 78,000 units.

All these additional hardships by the economy are expected to occur while domestic oil producers are reaping another \$10 billion to \$15 billion in new profits.

One of the most telling statistics in this high-risk game of trying to balance this budget is that a \$5-per-barrel tax will allegedly reduce the deficit by \$4 billion to \$9 billion in 1983. It may, however, increase the deficit by 1984 by some \$5 billion as the economy slows down as a result of Uncle Sam's self-imposed oil shock.

Mr. Chairman, members of the committee, the more than 70 cosponsors who have joined with me in this first week since the introduction of the House Resolution 430 find it unconscionable to levy this tax, particularly while the economy and consumers of this Nation are enduring this present economic situation.

I hope that one of the byproducts of this educational hearing is to heighten the awareness that Congress must send a proper message to the budget negotiators as soon as possible. And I invite this subcommittee to assist in generating cosponsorship of the House Resolution 430.

Thank you, Mr. Chairman.

Mr. MOFFETT. The Chair thanks the gentleman from Massachusetts.

The Chair now recognizes the gentleman from Indiana, Mr. Hiler.

Mr. HILER. Thank you, Mr. Chairman.

Thank you, Mr. Conte, for your statement and also for once again telling the world about that great victory that we had last year. I am looking forward to it again on June 14.

Who is it that is in favor of this \$5-a-barrel import fee?

Mr. CONTE. Well, it keeps coming up. Every time they look for some additional revenue, somebody suggests putting \$5 a barrel on here. In fact, only last week, after I filed my resolution, I had some members of that ad hoc budget negotiating committee come to me and say, "Will you pull off your opposition if we exclude home-heating oil?"

This really looks like an easy way to raise revenue. And it comes from the Budget Office, and it also comes from the so-called ad hoc budget negotiations committee.

As I say, we do have an ally in the Secretary of Energy. I wish I had his letter here. His letter is much more forceful than the small quote my staff put in here.

Mr. HILER. Well, keep up your efforts. I can't see any good that would come out of a \$5-per-barrel import fee.

Mr. MOFFETT. We will introduce into the record that letter and later a study from the Office of Competition in the Department of Energy.

[The information follows:]



THE SECRETARY OF ENERGY
WASHINGTON, D.C. 20585

April 14, 1982

Honorable Silvio O. Conte
House of Representatives
Washington, D.C. 20515

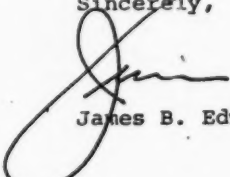
Dear Mr. Conte:

I was pleased to see your letter to the editor in the New York Times on March 23. I want you to know that I also oppose the imposition of an oil import fee. Hardly has the consumer had a chance to benefit from the lull in oil prices when, from all sides, conservative and liberal, come proposals for a new tax. I agree with you that the burdens of that tax would not be evenly distributed, but would fall on those heavy users of petroleum products that do not have the flexibility to switch: residential heating oil users in the Northeast; the already troubled automobile industry; chemical and refining industries; and every car owner that has watched gasoline prices finally drop.

I also believe that an oil import fee would have a damaging economic impact and create pressure for exemptions and special treatment under the law. Our past experience with quotas, taxes, price controls, and entitlements have taught us, at the very least, that we must make every effort to avoid such a course.

Let's find an opportunity to talk about this issue before the supporters of an oil import fee build up any more steam.

Sincerely,



James B. Edwards

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Mr. MOFFETT. The gentleman from Massachusetts, Mr. Frank.

Mr. FRANK. Thank you, Mr. Chairman.

I want to express the gratitude of the people of the Commonwealth for the leadership role that the gentleman from Massachusetts has taken on this.

The aggravating thing about this oil-import fee really was suggested by the question of the gentleman from Indiana, that it is kind of a phantom. Nobody is for it. But it keeps getting closer and closer to reality.

I think it is important to take the stand the gentleman has taken. Things have a way of suddenly happening here, with no authors and nobody there. I think that is one of the dangers of this ad hoc budget committee process, this kind of amorphous group of people. There is a real problem with accountability.

I would also congratulate the chairman for having the hearing today. This is a process that has been a little scary. It is very difficult to know just who the enemy is we are trying to come to grips with.

I think there is no question this fee would be wholly inefficient, unfair, inequitable. It is a very bad idea. We have to be very careful that the crisis and attitude of fiscal desperation doesn't lead us to do something stupid. And this would be stupid. And I just hope that we will be able to block it.

I want to say I again appreciate the initiative the gentleman has taken in bringing forward the facts. It is a very one-sided case. I think one of the reasons that we don't have publicly identified advocates for this is that it is very hard to make the argument for it. No one is really prepared to stand up and defend it publicly and openly.

I would think, Mr. Chairman—I assume we would have an invitation to anybody who was a strong advocate of it to come and let us know why they want it. But I don't expect we would get too many people coming forward for it.

I want to again thank the gentleman for his lead.

Mr. CONTE. I appreciate that. You know the danger of this whole thing is that the Budget Committee can come out with a budget resolution package, with reconciliation. We may be forced to vote the package up or down. Everybody knows you have to bring the deficit down. So you may be caught in this bind of choosing between higher deficits or higher fuel costs. We must derail any efforts to bring such a proposal to the floor for a vote.

Mr. FRANK. I appreciate it. We also do have the option of voting against motions to the previous question on the rule and on motions to recommit, and those are also there. But I agree with you that given what may happen, and this may all come down in a big crunch and people saying the Republic is tittering on the brink—it would be a good idea to lay bare now the lack of justification for this.

Mr. MOFFETT. The Chair recognizes the gentleman from New Hampshire, Mr. Gregg.

Mr. GREGG. I also want to congratulate the distinguished ranking member of the Appropriations Committee for putting this forward. Isn't it true that in New England at least, 65 percent or something like that, of our oil is imported oil?

Mr. CONTE. That is right. About 62 percent of our oil is imported. That is why we were very much opposed in 1959 to the import quota that was initiated by the Eisenhower administration. At that time we were buying oil at \$1.25 a barrel, if you can imagine. And we were saying, "Heck, we are 62 percent dependent on foreign oil, and by putting that quota on you are going to increase the price of oil and increase dollars in the the coffers of the oil companies."

We were very upset by this action. You ought to read some of my speeches from 1959, saying today we are going to be on bended knee begging for oil in this country, so why not use the cheap foreign oil from Venezuela and the Persian Gulf rather than using our oil.

Yet they did it for the oil companies.

There is a glut right now. There is a glut on oil right now. Imagine if you put a \$5 fee on imported oil. The domestic companies would bring their fee up \$5, and all the oil they have in storage, they would cash in on \$5 a barrel as a result of it.

Mr. GREGG. I think the implications at that point are apparent, and they are there. In fact, this almost appears to me to be a regional tax, which is directed at the Northeast.

Further, it is a double whammy. On balance the tax law passed last year was good. But a royalty allowance was put in which gives certain breaks to the oil-producing parts of this country. All right. Now we are saying we are going to pass an import oil tax which is going to hit the consumers, and it is a double whammy to the consumers in the Northeast.

I think it is a very regressive approach and clearly arbitrary and obviously discriminatory.

Mr. CONTE. Another point is we appropriate \$1.85 billion, and we had to fight like heck to get it, to help the poor people pay their oil bills this winter, and for the first time we see a little light at the end of the tunnel, and you are now going to jack it up \$5 a barrel and hit these poor people again.

Mr. GREGG. I hope you will put me down as a cosponsor of your bill.

Mr. CONTE. Thank you very much.

Mr. MOFFETT. Thank you very much, Mr. Conte.

Our next witnesses will appear as a panel. Dr. Mark Cooper, director of research, Consumer Energy Council of America; David Montgomery, senior fellow, Resources for the Future, and Mr. Stephen Sweeney, senior vice president of Boston Edison.

Gentlemen, please remain standing and be sworn.

[Witnesses sworn.]

Mr. MOFFETT. Thank you very much for being here, gentlemen.

Mr. Montgomery, you have two gentlemen with you. Would you introduce them for the record.

Mr. MONTGOMERY. Douglas Bohi and Harry Broadman.

Mr. MOFFETT. Before we begin with this panel, without objection the Chair will introduce into the record a statement on the oil import fee by the Honorable Barbara Kennelly, who cannot be here today, but who has made an excellent statement.

[Mrs. Kennelly's prepared statement follows:]

CONGRESSWOMAN BARBARA B. KENNELLY •
APRIL 27, 1982
STATEMENT ON THE OIL IMPORT FEE HEARING CONDUCTED BY THE
ENVIRONMENT ENERGY AND NATURAL RESOURCES SUBCOMMITTEE

Since I became a Member of Congress a few months ago, I have been very concerned about the proposal to impose an oil import fee as a method of reducing the federal deficit. One of my first actions as a Congresswoman was to cosponsor a resolution opposing these fees because of the disproportionate impact they have on the people of New England.

My region is heavily dependent on oil, and almost 80 percent of the oil is imported. Obviously, we would be hit very hard by the imposition of a fee on oil. The New England Congressional Institute recently estimated that the people of our region would pay 20 percent more per capita than the nation as a whole.

A \$5 per barrel import fee would increase the cost of domestic crude oil since domestic prices tend to rise with the cost of foreign crude. This means that the \$5 fee would most likely result in an increase of 12 cents per gallon on home heating oil, gasoline, and other petroleum products.

New England families using oil for space heating would have to pay, through an increase in prices of heating oil, gasoline, and electricity, and additional \$250 to \$300 annually.

Connecticut alone has 780,000 families who heat their homes with oil. These families would pay an extra \$195 to \$234 million annually for the purchase of oil products because of the fee. Those families who do not heat with oil would still experience higher gasoline and electrical costs.

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CONGRESSWOMAN BARBARA B. KENNELLY
APRIL 27, 1982
STATEMENT ON THE OIL IMPORT FEE HEARING CONDUCTED BY THE
ENVIRONMENT ENERGY AND NATURAL RESOURCES SUBCOMMITTEE

PAGE 2

One of my greatest concerns is the hardship the fee would impose on low and moderate income families. Very few people have an "extra" \$300 to spend for rising energy costs. This is especially true of the chronically poor, the working individual^{with} a family to support who is already having difficulty meeting mortgage payments, and the many individuals who have lost their jobs because of the recession.

The Reagan budget proposed a reduction in the low-income energy assistance program for the 1983 fiscal year. The oil import fee requires, however, an increase in our commitment to ensuring the poor have sufficient funds to heat their homes. The State of Connecticut estimates that the imposition of a \$5 per barrel oil import fee would add \$4 million to the cost of its energy assistance program.

Finally, the fee would increase the inflation rate by at least 1 percent and contribute to rising unemployment and a stagnant economy.

I am, therefore, adamantly opposed to the imposition of the oil import fee as a means of reducing the deficit, and am hopeful that this unfair and discriminatory proposal can be stopped before it becomes part of the budget compromise.

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Mr. MOFFETT. Dr. Cooper, we would like to begin with you, please. Without objection, your statement will be considered as part of the record. You may proceed in any fashion you wish.

**STATEMENT OF DR. MARK COOPER, DIRECTOR OF RESEARCH,
CONSUMER ENERGY COUNCIL OF AMERICA**

Dr. COOPER. Mr. Chairman, members of the subcommittee, my name is Dr. Mark Cooper and I am director of research of the Consumer Energy Council of America [CECA]. CECA is a broad-based coalition of major national consumer, labor, farm, public power, rural electric cooperative, senior citizen, urban, and low-income organizations.

I appreciate the opportunity to testify before the subcommittee today to present the results of CECA's comprehensive analysis of the implications of the proposed oil import fee and other forms of energy tax increases currently under discussion as budget-balancing measures.

These conclusions are documented in a report released today entitled: "A Comprehensive Analysis of the Impact of a Crude Oil Import Fee, Dismantling a Trojan Horse," which we submit to the committee, with your permission, for inclusion in the record.

I will briefly summarize several points in the study. In our analysis, we have made very conservative assumptions, conservative from the analytic point of view. Consequently, what we say about an import fee we think holds fairly well for some other forms of energy taxes that have been bandied about lately.

For instance, we start with a \$5 fee, but we only assume a 75-percent passthrough, which brings the price down to about \$3.75 a barrel. Further, we have assumed an effective tax rate on domestic price increase of 60 percent, which raises the overall tax rate from an import fee to slightly over 80 percent. The largest part of the fee as we see it, would be in the form of taxes.

Our basic conclusion is that energy taxes are counterproductive, totally, as energy, economic, budget balancing, social equity, and national security policy. As the chairman and a prior witness pointed out, several recent studies conducted by the executive and legislative branches of Government have reached conclusions similar to ours in the economic and budget balancing areas. So I will quickly deal with these.

Under our assumptions, the import fee would increase the Nation's oil bill by about \$21 billion. That is a figure roughly equal to seven-tenths of 1 percent of the gross national product. That is an oil price shock, the first energy price shock of the 1980's, that is roughly between one-third and one-quarter as large as the two oil price shocks of the 1970's, 1973-75, and 1979-81. That is a very large sum of economic resources. As we see it, the price shock of the fee would result in an increase of at least half a percentage point and perhaps 1 percentage point in the rate of inflation, a reduction in gross national product of about 1 percent, and an increase in unemployment of between two- and four-tenths of a percentage point.

We based our estimates on a very careful reading of the historical response of the economy to rising energy prices in the 1970's,

rather than on simulations of a projected import fee. And we think that these types of macroeconomic impacts would occur with similar magnitude for any energy price increase.

This severe dose of stagflation leads directly to a loss of Federal revenues and an increase in outlays. We differ from other studies in identifying exactly where we think those changes occur. We see a \$4.5 billion loss in Federal revenues due to a decline in receipts in nonenergy sectors. We see a \$1.8 billion increase in Federal outlays for unemployment and other social assistance programs. That is an increase due to increased enrollments in those programs.

In addition, we see a \$1.8 billion increase in Federal outlays due to inflation-indexed, individual, entitlement programs.

And, finally, we see a \$1 billion increase in other Government operating expenses due to inflation.

Therefore, more than half the gross revenues would be offset by revenue losses and outlay increases. All of the studies agree on this. In fact, most go a good deal farther than we do, suggesting almost a total revenue wipeout. But all pretty well agree that the oil tax chip being played in the budget-balancing poker game is a lot smaller than it actually looks.

What the other studies have not looked at in detail are the efficiency, national security, and equity impacts of the fee. I would like to dwell on these.

As one who has participated in the decontrol debate and listened to the constant battle cry of Government and industry that market pricing is the most efficient approach to energy problems, the sudden turnabout by some members of the energy industry and Government constitutes the ultimate hypocrisy.

As long as energy prices are rising they seem to be saying leave the market alone, but once prices start to fall, then Government must step in to prop them up. This is the ultimate slap in the consumers' face.

In our report we engage in a little turnabout is fair play ourselves. We have calculated that overpricing would lead to pure economic waste on the order of \$1 billion per year.

That is a sum roughly equal to one-sixth the inefficiency that the advocates of decontrol claim to have found in the so-called underpriced energy market of the 1970's. If you took their argument seriously then, you should be very concerned about the inefficiency of overpricing now. And if you didn't take their argument seriously, the pure economic waste would be even larger.

Some will say that this nonmarket inefficiency coupled with the short-term economic losses to which we have heard numerous references are the price we should pay for improving our national security, our national energy security. We share with serious students of the national energy security problem a genuine concern about the energy situation. But we do not believe that imports are the problem, or that raising energy prices is the simple solution.

But even if we were convinced that imports were the problem, we would still very seriously doubt the effectiveness of further energy price increases as a response to it.

Since decontrol has driven up the domestic price of oil and gas by over 250 percent in roughly a 3-year period, additional price increases would produce miniscule savings, perhaps 300,000 barrels a

day. This represents less than 2 percent of non-OPEC free world production and even a smaller proportion of non-OPEC productive capacity, less than 3 percent of current OPEC surplus capacity, less than 15 percent of the current world excess supply. It won't make a whit of difference in the world oil and energy markets.

At the same time, and more importantly, there are strategic alternative measures available which are far more effective and far less costly.

We could resurrect the conservation programs recently dismantled by the Reagan administration and almost certainly save as much energy at a fraction of the cost.

The strategic petroleum reserve already contains 2.5 times more oil and for the price of an oil import fee we could add 6 times as much oil to the strategic reserve every year.

Organizations that are not likely to overestimate conservation potential, such as the National Petroleum Council and the American Petroleum Institute have identified short-term measures that would produce 10 times as much energy savings on a short-term strategic response basis and the total cost would be less.

The Solar Energy Research Institute, National Academy of Sciences and Resources for the Future have identified mid- and long-term strategies that will yield savings at least 10 times as large.

Grasping at an energy price increase as the only strategic energy measure that can be wrung out of an administration that has turned its back on the problem and doing so under the guise and in the midst of budget considerations may do more harm than good. Misspent resources can in fact be worse than not spending them at all.

The price tag of an import fee is so hideously high that it will undermine, preempt and short circuit all future attempts to work out an effective policy. We will constantly hear that we have already paid the price, we do not need more energy security measures. We should not buy a bad one simply because we think it is the only one we can get.

As bad as the absence of efficiency and national security analysis in most of the Government studies is, that lack is a small matter when compared to the utter neglect of equity analysis in those studies.

Energy taxes are really part of a massive national tax shell game. The same policymakers who created last year's regressive tax cuts, and this year's budget deficits are now trying to close or threatening to close the deficits with even more regressive tax increases next year. And energy taxes, whether in the form of import fees or Btu taxes or excise taxes, are cruelly regressive, especially when compared to last year's tax cuts.

When the burden of the import fee is compared to the total of the personal tax cuts legislated last year, we find that the lowest income group, 23 percent of the population which earns less than \$10,000 per year, will have almost two-thirds of its tax cut erased by the fee and its associated price increases. The lower middle income group representing 25 percent of the population, earning between \$10,000 and \$20,000 per year, and the middle income group, 35 percent of the population earning between \$20,000 and \$40,000 per year, will lose one-third of their tax cuts. The upper

middle class, 16 percent of the population, earning between \$40,000 and \$80,000 per year, will lose less than one-sixth of their tax cuts, and the wealthy, that 1 percent of the population earning above \$80,000 per year, will probably lose none, because they benefit from increased oil company profits.

There are other ways, we have about four different ways, of representing the inequity of these taxes. But there is one basic conclusion. They are grossly inequitable to everyone but the richest 20 percent of the population.

The crushingly regressive nature of the import fee leads us back, we believe, to basic economics and the concluding, crowning irony of the fee which other studies have missed. Raising energy taxes to balance the budget and help the economy is like chasing your tail. The more you raise taxes on vital necessities, such as energy, the harder you have to run to keep up because you reduce purchasing power for the vast majority and therefore decrease the level of economic activity.

This is a terribly ironic danger lurking in the fee and the reason we have subtitled our report "Dismantling a Trojan Horse."

How will this Congress and this administration fight the increase in inflation, after an energy tax puts another point back on inflation? They will try to wring the inflation out of the economy by praising and encouraging tight money, and that means more recession and less revenue.

How will this Congress and administration respond to a \$4 to \$6 billion increase in unemployment and social assistance expenditures caused by inflation and recession?

They will try to wring it out of the people programs. And that means more regressive reductions in purchasing power for the vast majority of the Nation's households. And that means more recession and less revenue.

The circles that the budget balancers run can become long spirals leading from recession into depression. The citizens of Troy unwittingly wheeled the engine of their own destruction within the walls of their city because they desperately wanted to see the horse as a symbol to an end of a difficult period.

We believe that the administration and Congress would do much the same if they let energy price increases worm their way into our national budget balancing act as revenue enhancement. It is simply an illusion that leads the unwitting to defeat.

Let me put the matter in another way for those who prefer more modern history. We might recall a series of events from the recession of 1929-31. A Republican President and a Democratic Congress joined forces to raise taxes in the midst of a recession, and most economists agree that was a huge mistake.

It seems that policymakers in Washington have worked themselves into a similar state of mind. We at the Consumer Energy Council sincerely hope that they don't make a similar mistake. We believe increasing taxes on vital necessities, such as energy, in the midst of the longest deepest recession since the Great Depression, is utter economic suicide.

Thank you.

Mr. MOFFETT. Thank you, Dr. Cooper.

[Dr. Cooper's prepared statement and council overview follow:]

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 American Psychological
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$\text{var}(\hat{\beta}_1) = \frac{\sigma^2}{n \sum_{i=1}^n (x_i - \bar{x})^2}$
 $\text{var}(\hat{\beta}_2) = \frac{\sigma^2}{n \sum_{i=1}^n x_i^2 - n \bar{x}^2}$
 $\text{var}(\hat{\beta}_3) = \frac{\sigma^2}{n \sum_{i=1}^n x_i^2 - n \bar{x}^2}$
 $\text{var}(\hat{\beta}_4) = \frac{\sigma^2}{n \sum_{i=1}^n x_i^2 - n \bar{x}^2}$

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DISCUSSION

11. **WATER**
 12. **SOIL**
 13. **CLIMATE**

1. 2000年1月1日起，凡在我国境内销售货物的单位和个人，均应按销售额的一定比例缴纳增值税。

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Before the
Subcommittee on Environment, Energy
and Natural Resources
Committee on Government Operations
U.S. House of Representatives

on the
Proposed Implementation of
an Oil Import Fee

April 27, 1982

Mr. Chairman and Members of the Subcommittee:

My name is Dr. Mark Cooper and I am Director of Research of the Consumer Energy Council of America (CECA). CECA is a broad-based coalition of major national consumer, labor, farm, public power, rural electric cooperative, senior citizen, urban, and low income organizations (see attached list).

I appreciate the opportunity to testify before the Subcommittee today to present the results of CECA's comprehensive analysis of the implications of the proposed oil import fee and other forms of energy tax increases currently under discussion as budget-balancing measures. ^D These conclusions are documented in a report released today, entitled "A Comprehensive Analysis of the Impact of a Crude Oil Import Fee: Dismantling a Trojan Horse," which we submit, with your permission, for inclusion in the record. I will briefly summarize several key points in my remarks.

Let me say at the outset that we find energy tax increases to be totally counter-productive as energy, economic, budget-balancing, social equity, and national security policy.

1. ECONOMIC IMPACTS

CECA's analysis estimates the economic impacts of the fee, both on the basis of the historical record of the

- 1 -

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economy's response to rising energy prices in the 1970s and recent simulations of the effects of the fee. We find that the oil import fee would create a significant shock to the economy resulting in a strong dose of stagflation.

For the purposes of analysis, we have made the following assumptions:

- o The fee would be \$5 per barrel. However, due to the supply and demand conditions in the market, we assumed that only three-quarters of the fee would be passed through to consumers.
- o Domestic oil prices would rise to the effective price of imports.
- o With a modest economic recovery, imports would rise to 5.5 million barrels per day.
- o Domestic crude supply would be 8.6 million barrels per day and an additional 1 million barrels per day of natural gas liquids would exhibit the same price increases as crude oil.

Under these assumptions, the import fee and the associated increases in domestic energy prices would provide a serious energy price shock to the economy:

- o The oil import fee would increase the nation's oil bill by about \$21 billion -- a figure equal to roughly seven-tenths of a percent of Gross National Product (GNP).
- o This oil price shock is between one-third and one-quarter of the magnitude of the oil price shocks of 1973-75 and 1979-81.

The price shock resulting from the import fee would cause the following major economic losses:

- o an increase in inflation of at least half a percentage point and perhaps more than one percentage point,
- o a reduction in GNP of between .65 and 1.25 percent, and

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- 3 -

- o an increase in unemployment of between two-tenths and four-tenths of a percentage point, a loss of approximately 200,000 to 400,000 jobs.

2. ENERGY MARKETS

Reviewing the recent history of energy price policy in the United States, we find that an import fee cannot be justified on economic efficiency grounds. This is true from the point of view of both those who have supported deregulation in the name of market pricing and those who have opposed deregulation.

- o From either point of view, there is one resounding conclusion: overpricing of energy leads to serious inefficiencies and misallocation of resources.
- o We estimate that the pure economic efficiency costs of the fee -- simple economic waste -- would certainly be on the order of \$1 billion per year and could be much more.

3. REVENUE RAISING POTENTIAL

Although the fee appears to be a major revenue raising measure, producing direct revenue gains of up to \$17.2 billion, careful analysis shows that the stagflationary impact of the fee dramatically undermines its effectiveness as a revenue raiser.

We estimate that the fee's revenue-raising potential would be reduced by:

- o \$4.5 billion (28 percent of the gross revenues), due to the decline of tax receipts in non-energy sectors of the economy;
- o \$1.8 billion (11 percent of the gross revenues), due to additional federal outlays

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- 4 -

resulting from increased enrollments in unemployment and other social assistance programs;

- o \$1.8 billion (11 percent of the gross revenues), due to increases in federal outlays from inflation-indexed entitlements for individuals;
- o \$1.0 billion (6 percent of the gross revenues), due to other inflation-related increases in federal outlays.

Consequently, more than half of the gross revenues would be lost or offset. Thus, from a \$21 billion dollar increase in the national oil bill, the net revenue gains of the fee would be less than \$8 billion.

4. SOCIAL EQUITY

CECA's analysis finds the fee to be extremely inequitable in the burden it places on households, whether viewed on its own, or in relation to the recent tax cuts, which, in part, it is intended to offset.

Individual households will incur increased costs of:

- o approximately \$70 per year for gasoline;
- o about \$170 per year for indirect energy expenditures for goods and services produced with petroleum product inputs; and
- o about \$70 per year in heating bills for those who heat with oil.

Since these increased costs are a direct result of a measure -- the oil import fee -- which increases federal tax revenues, the fee can be viewed as simply offsetting some of last year's tax cuts. From one point of view, i.e., when the

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- 5 -

burden of the fee is compared to the total of the personal tax cuts legislated last year, we find that:

- o The lowest income group (the 22.5 percent of the population earning less than \$10,000 per year) will have almost two-thirds of its tax cuts erased by the fee and its associated price increases.
- o The lower middle income group (24.8 percent of the population earning between \$10,000 and \$20,000 per year) and the middle income group (35.2 percent of the population earning between \$20,000 and \$40,000 per year) will lose one-third of their tax cuts.
- o The upper middle class (16.3 percent of the population earning between \$40,000 and \$80,000 per year) will lose less than one-sixth of their tax cuts.
- o The wealthy (1.2 percent of the population which earns more than \$80,000) will lose none of their tax cuts at all, because they benefit from increased oil company profits.

From another point of view, i.e., when the burden of the fee is compared to an equal amount of last years tax cuts, we find that:

- o The richest 1.2 percent of the population will be big winners in the tax shell game, ending up about \$4 billion better off, and the next richest 16.3 percent of the population will end up \$1 billion better off.
- o The low income and lower middle income groups each will be about \$1 billion worse off.
- o The middle income group will be the big losers, ending up \$3 billion worse off.

With respect to general equity, we conclude the following:

- o The low income and lower middle income groups will pay a disproportionately larger share of the price increases that will result from the oil import fee than higher income groups.

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- 6 -

- o The middle income group will pay roughly in proportion to its share of income.
- o The upper middle income group and the wealthy will pay much less than their share of income.

Regardless of how the burden of the fee and its associated price increases is viewed, it is grossly inequitable to everyone but the richest 20 percent of the population.

5. NATIONAL ENERGY SECURITY

Although CECA recognizes the legitimate concerns of those who believe we still have a major national energy problem, we seriously doubt that the problem is simply an import problem and we doubt that an import fee is the simple solution. Above all, we are convinced that the fee is among the least effective responses we have available to the national security problem caused by imports.

Since decontrol has driven up the domestic price of oil by over 300 percent, additional price increases associated with the import fee would produce miniscule savings -- perhaps 300,000 barrels per day.

- o This represents less than 2 percent of the non-OPEC free world production and an even smaller portion of non-OPEC productive capacity.
- o This represents less than 3 percent of OPEC's currently underutilized capacity.
- o This represents less than 15 percent of the current world excess of supply.

Moreover, with the recent rapid expansion of non-OPEC production capacity and the declining energy intensity of

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output in the industrialized nations of the West, even these small percentages may overstate the importance of a mere 300,000 barrels per day.

While the potential national security benefits of the fee are small and the price is high -- \$21 billion in direct cost increases, plus a serious inflationary/recessionary shock -- there are alternative strategic measures available which are far more effective and far less costly.

- o The energy savings potential of federal energy conservation programs recently dismantled by the Reagan Administration almost certainly equals the potential of the fee, at a fraction of the cost.
- o As the instantaneous response to a crisis, the Strategic Petroleum Reserve already contains about 2.5 times more oil than the import fee will save next year. For the same price we would pay for the oil import fee, we could add six times as much oil per year to the strategic reserve.
- o The National Petroleum Council, the American Petroleum Institute and the Department of the Treasury have identified short term measures that would produce ten times as much energy savings on a short term strategic response basis, the total cost of which would probably be smaller.
- o The Solar Energy Research Institute, the National Academy of Sciences and Resources for the Future have identified mid and long term strategies that would yield savings at least ten times as large.

6. CONCLUSION

CECA's analysis concludes that the oil import fee is a bad policy choice from all five points of view -- energy, economic, budget, social equity and national security policy.

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Adams Electric Cooperative, Inc.
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 Amalgamated Clothing & Textile Workers Union, AFL-CIO
 American Federation of State, County & Municipal Employees, AFL-CIO
 American Federation of Teachers, AFL-CIO
 American Public Power Association
 Association of Illinois Electric Cooperatives
 Association of Texas Electric Cooperatives Inc.
 Basin Electric Power Cooperative
 Central Power Electric Cooperative, Inc.
 Citizen/Labor Energy Coalition
 Consumer Federation of America
 Cooperative League of the USA
 East River Electric Power Cooperative, Inc.
 Florida Electric Cooperatives Association
 Hoosier Energy Division, Indiana Statewide Rural Electric Cooperative
 Industrial Union Department, AFL-CIO
 International Association of Machinists and Aerospace Workers, AFL-CIO
 International Molders and Allied Workers Union, AFL-CIO
 Kansas Electric Cooperatives, Inc.
 Kansas Municipal Utilities
 Lincoln (Nebraska) Electric System
 Marine Engineers Beneficial Association
 Maritime Trades Department, AFL-CIO
 Minnesota Farmers Union
 National Community Action Agency Executive Directors Association
 National Council of Senior Citizens
 National Farmers Organization
 National Farmers Union
 National Rural Electric Cooperative Association
 North Carolina Electric Membership Corporation
 North Dakota Farmers Union
 Northeast Missouri Electric Power Cooperative
 Northeast Public Power Association
 Northwest Iowa Power Cooperative
 Northwest Public Power Association
 Oil, Chemical and Atomic Workers International Union, AFL-CIO
 Pennsylvania Rural Electric Association
 Rocky Mountain Farmers Union
 Service Employees International Union, AFL-CIO
 South Dakota Farmers Union
 Southside Electric Cooperative Inc.
 Tennessee Valley Public Power Association
 Texas AFL-CIO
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A COMPREHENSIVE ANALYSIS OF THE IMPACT OF A CRUDE OIL IMPORT FEE: DISMANTLING A TROJAN HORSE

OVERVIEW

Prepared by
CONSUMER ENERGY COUNCIL OF AMERICA
RESEARCH FOUNDATION

April 1982

Price: \$25

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EXECUTIVE SUMMARY

In this report the Consumer Energy Council of America Research Foundation undertakes a comprehensive analysis of the impact and implications of an oil import fee with respect to energy market efficiency, economic activity, revenue raising potential, social equity and national security. On all counts we find the fee to be a counter-productive policy.

1. ECONOMIC IMPACTS

CECA/RF's analysis estimates the economic impacts of the fee, both on the basis of the historical record of the economy's response to rising energy prices in the 1970s and recent simulations of the effects of the fee. We find that the oil import fee would create a significant shock to the economy resulting in a strong dose of stagflation.

For the purposes of analysis, we have made the following assumptions:

- o The fee would be \$5 per barrel. However, due to the supply and demand conditions in the market, we assumed that only three-quarters of the fee would be passed through to consumers.
- o Domestic oil prices would rise to the effective price of imports.
- o With a modest economic recovery, imports would rise to 5.5 million barrels per day.
- o Domestic crude supply would be 8.6 million barrels per day and an additional 1 million barrels per day of natural gas liquids would exhibit the same price increases as crude oil.

Under these assumptions, the import fee and the associated increases in domestic energy prices would provide a serious energy price shock to the economy:

- o The oil import fee would increase the nation's oil bill by about \$21 billion -- a figure equal to roughly seven-tenths of a percent of Gross National Product (GNP).
- o This oil price shock is between one-third and one-quarter of the magnitude of the oil price shocks of 1973-75 and 1979-81.

The price shock resulting from the import fee would cause the following major economic losses:

- o an increase in inflation of at least half a percentage point and perhaps more than one percentage point,
- o a reduction in GNP of between .65 and 1.25 percent, and
- o an increase in unemployment of between two-tenths and four-tenths of a percentage point, a loss of approximately 200,000 to 400,000 jobs.

2. ENERGY MARKETS

Reviewing the recent history of energy price policy in the United States, we find that an import fee cannot be justified on economic efficiency grounds. This is true from the point of view of both those who have supported deregulation in the name of market pricing and those who have opposed deregulation.

- o From either point of view, there is one resounding conclusion: overpricing of energy leads to serious inefficiencies and misallocation of resources.
- o We estimate that the pure economic efficiency costs of the fee -- simple economic waste -- would certainly be on the order of \$1 billion per year and could be much more.

3. REVENUE RAISING POTENTIAL

Although the fee appears to be a major revenue raising measure, producing direct revenue gains of up to \$17.2 billion, careful analysis shows that the stagflationary impact of the fee dramatically undermines its effectiveness as a revenue raiser.

We estimate that the fee's revenue-raising potential would be reduced by:

- o \$4.5 billion (28 percent of the gross revenues), due to the decline of tax receipts in non-energy sectors of the economy;
- o \$1.8 billion (11 percent of the gross revenues), due to additional federal outlays resulting from increased enrollments in unemployment and other social assistance programs;
- o \$1.8 billion (11 percent of the gross revenues), due to increases in federal outlays from inflation-indexed entitlements for individuals;
- o \$1.0 billion (6 percent of the gross revenues), due to other inflation-related increases in federal outlays.

Consequently, more than half of the gross revenues would be lost or offset. Thus, from a \$21 billion dollar increase in the national oil bill, the net revenue gains of the fee would be less than \$8 billion.

4. SOCIAL EQUITY

CECA/RF's analysis finds the fee to be extremely inequitable in the burden it places on households, whether viewed on its own, or in relation to the recent tax cuts, which, in part, it is intended to offset.

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Individual households will incur increased costs of:

- o approximately \$70 per year for gasoline;
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- o about \$70 per year in heating bills for those who heat with oil.

Since these increased costs are a direct result of a measure -- the oil import fee -- which increases federal tax revenues, the fee can be viewed as simply offsetting some of last year's tax cuts. From one point of view, i.e., when the burden of the fee is compared to the total of the personal tax cuts legislated last year, we find that:

- o The lowest income group (the 22.5 percent of the population earning less than \$10,000 per year) will have almost two-thirds of its tax cuts erased by the fee and its associated price increases.
- o The lower middle income group (24.8 percent of the population earning between \$10,000 and \$20,000 per year) and the middle income group (35.2 percent of the population earning between \$20,000 and \$40,000 per year) will lose one-third of their tax cuts.
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From another point of view, i.e., when the burden of the fee is compared to an equal amount of last years tax cuts, we find that:

- o The richest 1.2 percent of the population will be big winners in the tax shell game, ending up about \$4 billion better off and the next richest 16.3 percent of the population will end up \$1 billion better off.
- o The low income and lower middle income groups each will be about \$1 billion worse off.
- o The middle income group will be the big losers, ending up \$3 billion worse off.

With respect to general equity, we conclude the following:

- o The low income and lower middle income groups will pay a disproportionately larger share of the price increases that will result from the oil import fee than higher income groups.
- o The middle income group will pay roughly in proportion to its share of income.
- o The upper middle income group and the wealthy will pay much less than their share of income.

Regardless of how the burden of the fee and its associated price increases is viewed, it is grossly inequitable to everyone but the richest 20 percent of the population.

5. NATIONAL ENERGY SECURITY

Although CECA/RF recognizes the legitimate concerns of those who believe we still have a major national energy problem, we seriously doubt that the problem is simply an import problem and we doubt that an import fee is the simple solution. Above all, we are convinced that the fee is among

the least effective responses we have available to the national security problem caused by imports.

Since decontrol has driven up the domestic price of oil by over 300 percent, additional price increases associated with the import fee would produce miniscule savings -- perhaps 300,000 barrels per day.

- o This represents less than 2 percent of the non-OPEC free world production and an even smaller portion of non-OPEC productive capacity.
- o This represents less than 3 percent of OPEC's currently underutilized capacity.
- o This represents less than 15 percent of the current world excess of supply.

Moreover, with the recent rapid expansion of non-OPEC production capacity and the declining energy intensity of output in the industrialized nations of the West, even these small percentages may overstate the importance of a mere 300,000 barrels per day.

While the potential national security benefits of the fee are small and the price is high -- \$21 billion in direct cost increases, plus a serious inflationary/recessionary shock -- there are alternative strategic measures available which are far more effective and far less costly.

- o The energy savings potential of federal energy conservation programs recently dismantled by the Reagan Administration almost certainly equals the potential of the fee, at a fraction of the cost.
- o As the instantaneous response to a crisis, the Strategic Petroleum Reserve already contains about 2.5 times more oil than the import fee will save next year. For the same price we would pay for the oil import fee, we could add six times as much oil per year to the strategic reserve.

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xiv

- o The National Petroleum Council, the American Petroleum Institute and the Department of the Treasury have identified short term measures that would produce ten times as much energy savings on a short term strategic response basis, the total cost of which would probably be smaller.
- o The Solar Energy Research Institute, the National Academy of Sciences and Resources for the Future have identified mid and long term strategies that would yield savings at least ten times as large.

6. CONCLUSION

CECA/RF's analysis concludes that the oil import fee is a bad policy choice from all five points of view -- energy, economic, budget, social equity and national security policy.

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I. AN OVERVIEW OF THE ANALYSIS AND
BASIC CONCLUSIONS

A. Introduction

In this report, the Consumer Energy Council of America Research Foundation (CECA/RF) undertakes a comprehensive analysis of the impacts and implications of a crude oil import fee. The study examines in detail:

- o The impact of the fee on the economy -- whether it increases or decreases economic output and activity.
- o The effectiveness of the fee as a revenue raising measure -- how much revenues are actually raised and at what cost.
- o The social equity impact of the fee -- who bears the cost and who reaps the benefit of the fee.

The study also briefly reviews:

- o The implications of the fee for national energy security policy and
- o The impact of the fee on the efficiency of energy markets.

This chapter gives an overview of the issues involved in the imposition of the fee and the basic conclusions and implications of CECA/RF's analysis. We are convinced on the basis of this analysis that an import fee is certain to be a failure not only as energy policy, but also as economic policy, as a budget balancing tool, as social equity policy, and as a national security measure.

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B. The Irony of an Import Fee
as Energy Price Policy

Over the past decade, the American public has been told continually by the federal government, the executive branch in particular, the energy industry and a cacophany of august free market economists that market pricing of energy resources is the only workable solution to the energy problem. Each time OPEC raised its prices we heard -- and the Administration ultimately capitulated to -- a call to decontrol another part of the energy industry so that proper market signals could be sent to domestic producers and consumers.

Over that decade, hundreds of billions of dollars were spent on rising energy bills, with much more than half of it going to domestic producers. Moreover, if we are to believe recent reports in Business Week and other respected journals, we sacrificed a decade of economic growth at the altar of rising market prices of energy:

Reeling from the twelvefold price increase from 1973 to 1981, the industrial nations -- nurtured on more than a century of cheap energy -- not only went plummeting into two recessions but also suffered further as inflation rates soared to record levels. [Business Week, March 22, 1982, p. 66]

Yet, now, at a critical moment in the history of energy markets -- the first moment in a decade when there are serious indications that energy prices can decline as well as -- rise -- we find that the faith which government, industry and economists placed in the free market is shaken. We suddenly hear calls for the imposition of an import fee in order to override the signals that the market is sending. These

analysts seem to believe that as long as prices are rising the marketplace must be working properly and, therefore, government should leave it alone. But, if prices should start to fall, then the marketplace must be malfunctioning and government should intervene to bolster prices.

This schizophrenic attitude toward the marketplace is hard to justify on rational economic grounds. Skepticism of this turnabout and the justification put forward to defend it is certainly warranted on the part of both those who have supported and those who have opposed the previous policy of deregulation of energy prices.

For those who have supported deregulation in the interest of free market pricing of energy resources, this turnabout constitutes a distortion of market forces that would apply not only to oil, but to all energy sources.⁶ For those who have opposed deregulation, the turnabout constitutes the ultimate proof that energy markets have and always will be manipulated to further the narrow, self-interests of the energy companies, not the national interest.

From either point of view, there is one resounding conclusion: overpricing of energy leads to serious inefficiencies and misallocation of resources. Our estimates are that the pure economic efficiency costs of a fee -- simple economic waste -- would be on the order of \$1 billion per year.

C. The Absurdity of the Fee
as Economic Policy

Not only is the oil import fee difficult to justify as energy policy; it makes no sense as economic policy, either. The following is a brief review of the results of our analyses which lead to that conclusion.

1. Assumptions

For the purposes of analysis, we have made the following assumptions:

- o The fee would be \$5 per barrel. However, due to the supply and demand conditions in the market, we assumed that only three-quarters of the fee is passed through to consumers.
- o Domestic oil prices rise to the effective price of imports.
- o With a modest economic recovery, imports rise to 5.5 million barrels per day.
- o Domestic crude supply is 8.6 million barrels per day and an additional 1 million barrels per day of natural gas liquids behave like crude oil in terms of price increases.

Under these assumptions, the import fee and the associated increase in domestic oil prices would represent an increase in the nation's oil bill of \$21 billion. This staggering sum of money roughly equals seven-tenths of one percent of GNP. It would create a shock to the economy that is between one-third and one-quarter the magnitude of the oil price shocks of 1973-75 and 1979-81.

2. Macroeconomic Impacts

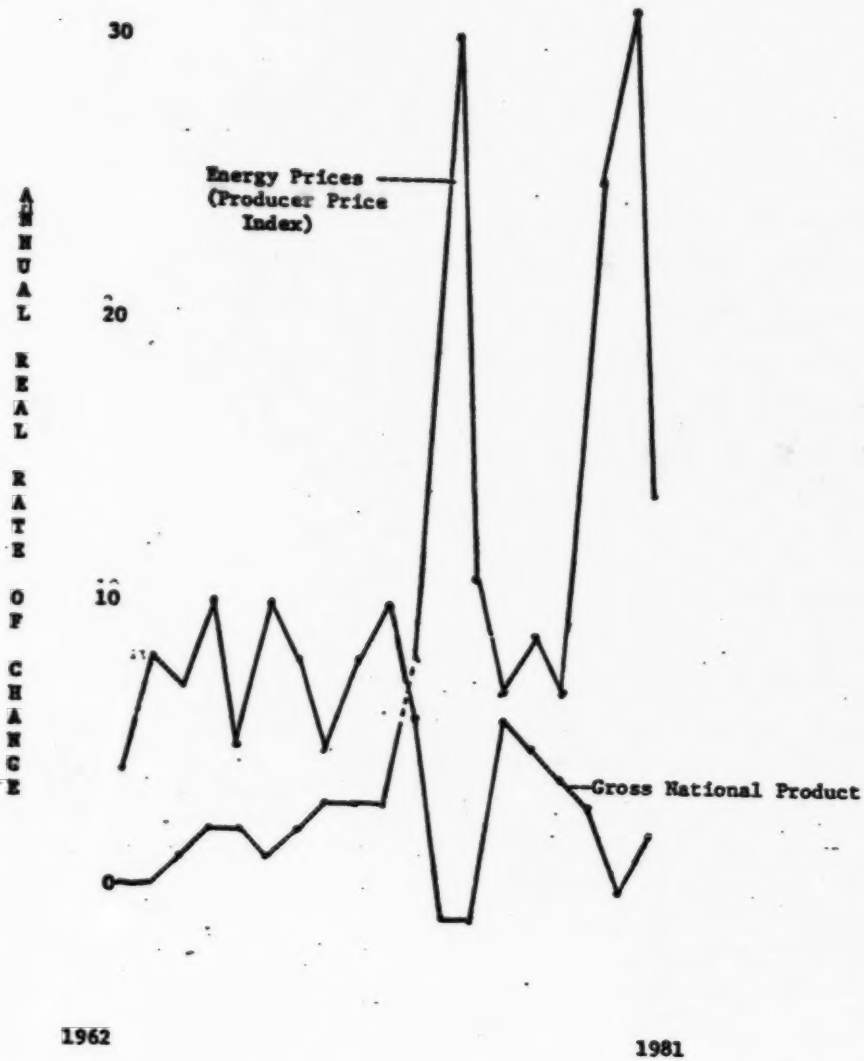
Both the historical experience of the massive impact that rising oil prices had on the economy in the 1970s and recent econometric analyses of the fee itself suggest that the price shock associated with the imposition of the fee would have serious inflationary and recessionary effects on the economy.

Figure 1 compares the annual rate of change in energy prices to the annual rate of change in economic activity over the past two decades. Note the dramatic coincidence of the peaks of energy price increases and the valleys of economic activity; clearly, energy price increases have consistently produced severe pitfalls of economic activity. This historical record should be especially sobering to any who would glibly raise oil prices.

Our projections of the impact of the import fee based on a careful review of a dozen econometric analyses of the oil price shocks of the 1970s, including five different econometric models, as well as the recent econometric analyses of a fee (see Table 1), lead us to conclude that the import fee would:

- o cause an increase in inflation of at least half a percentage point and perhaps more than one percentage point,
- o cause a reduction in GNP of between .65 and 1.25 percent, and
- o result in an increase in unemployment of between two-tenths and four-tenths of a percentage point.

FIGURE 1
ENERGY PRICE CHANGES AND CHANGES
IN THE GROSS NATIONAL PRODUCT



SOURCE: U.S. Bureau of Labor Statistics
Commerce Department

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Table 1

ESTIMATED ECONOMIC IMPACTS OF AN IMPORT FEE (Average Annual Change Over Three Years)

Source of Estimate	Size of Fee (\$/bbl)	Pass-Through (%)	Effective Fee	CPI Change (Percentage Pts)			GDP Change (Percent)			Unemployment Change (Percentage Pts)		
				Low	Mid	High	Low	Mid	High	Low	Mid	High
CECA Projection Based on Historical Record ^{a/}	5.00	75	3.75	+ .37	+ .46	+ .54	-.65	-.87	-1.08	+ .17	+ .31	+ .45
Wharton ^b	5.00	100	5.00	—	+1.25	—	—	-1.25	—	—	—	—
CBO ^c	5.00	67	3.35	+ .6	+ .75	+ .9	—	.6	.70	.1	.45	.2
DOE DRI ^d	5.00	100	5.00	—	+ .53	—	—	-.53	—	—	+ .33	—
CIS ^e	5.00	100	5.00	—	+ .5	—	—	-.9	—	—	+ .30	—

Sources:

^aCECA calculations, see text.

^bWharton Econometric Associates Long Range Forecast, cited in Business Week, April 5, 1982, p. 28. The \$5 fee is scaled up from the \$4 fee.

^cCongressional Budget Office, Oil Import Fees, March 22, 1982.

^dU.S. Department of Energy, Energy Information Administration, Economic Impact of an Oil Import Fee, March 19, 1982.

^eBernard A. Gelb and Everson W. Hull, Revenue and Macroeconomic Impacts of an Oil Import Tax: A Brief Review (Congressional Research Services, April 6, 1982).

88

In general, there is close agreement between our projections based on the historical record and the analyses conducted by the Congressional Budget Office, the Department of Energy, the Congressional Research Service and Wharton Econometrics cited in Table 1. The fee leads to a serious dose of stagflation, sufficiently serious to be called the first oil price shock of the 1980s -- a needlessly self-inflicted wound.

D. The Illusion of the Fee as a
Revenue Raising Strategy

On the surface, the fee would appear to increase federal gross revenue collection dramatically (see Table 2); however, the resulting economic impacts would quickly eat away at the anticipated federal revenue gains. Our analysis shows that, prior to the erosion of revenues:

- o Imports would yield additional federal revenues of about \$9.5 billion.
- o Increases in oil company profits would be taxed at the wellhead or as corporate income and would yield an additional \$7.7 billion in federal revenue.
- o The total increase in gross revenues would be \$17.2 billion.
- o The increase in after tax profits of oil companies would be \$3.4 billion.

At the same time, the recessionary/inflationary impact of the oil price shock would dramatically reduce

Table 2

REVENUE EFFECTS OF THE IMPORT FEE
(Base Case Assumptions)

	\$ Billion (per year)	% of Gross Revenue Gains
Total increase in national oil bill	20.6	—
Import revenue	+ 9.5	55
Domestic tax revenue	+ 7.7	45
Gross revenue gains	+ 17.2	100
Oil company after tax profits	3.4	—
Revenue losses	- 4.8	28
Outlay increases due to increases in unemployment	- 1.8	21
Outlay increases due to inflation indexed entitlements for individuals	- 1.8	11
Outlay increases due to other inflation related expenses	- 1.0	6
Indirect revenue losses	- 9.4	55
Net revenue	+ 7.8	45

Source: ECA calculations, see text.

federal revenues from other sources and dramatically increase federal outlays. We estimate as a base case that:

- o About \$4.8 billion (28 percent of the gross revenues) would be lost due to the decline of tax receipts in non-energy sectors of the economy.
- o Increases in federal outlays due to the increase in enrollments in unemployment and other social assistance programs would eat up \$1.8 billion (11 percent of the gross revenue increases).
- o Increases in federal outlays due to inflation-indexed entitlements for individuals would eat up another \$1.8 billion (11 percent of the increase in gross revenues).
- o Other inflation related outlay increases would be \$1.0 billion (6 percent of the gross revenue).

Consequently, more than half of the gross revenues would be lost or offset. The net impact on revenues would be an increase of about \$7.8 billion. Thus, from a \$21 billion increase in the national oil bill, the government realizes only \$7.8 billion in net revenue additions, about 40 cents on the dollar -- hardly an efficient way to approach the problem.

Finally, one must recognize that the price of other energy sources -- gas in particular -- will track the price of oil fairly closely and that the effective tax rate on those price increases will be much lower than the effective tax rate on the oil price increase. In this context, the import fee appears even less efficient as a revenue generator. The increase in the total national energy result of the fee will probably be closer to \$30

billion and the government revenue increases will probably be less than 33 cents on the dollar.

Thus, because of the link between economic activity and federal revenues and outlays, the fee makes no sense as either an economic policy or as a budget balancing tool. Moreover, any residual benefits that its supporters might project from the fee because of its potential contribution to a reduction in the deficit -- with respect to interest rates, for example -- would certainly be offset by the sharp inflationary jolt that the fee would send through the economy.

E. The Cruelty of the Import Fee as Social Equity Policy

As bad as the fee is from the point of view of energy, economic and revenue policy, it is worse still from the point of view of social equity. Increases in federal revenues resulting from the fee and its associated price increases would come in the form of commodity price increases which are taxed in one way or another. That is, the fee raises revenue directly, which appears as price increases for imported oil. It also allows domestic petroleum prices in general to rise, and this leads to higher oil company profits and higher tax revenues. Increased petroleum prices mean higher prices for goods and services. Regardless of the route that revenue increases take, they mean increases in the prices of goods and services.

These tax increases are ultimately borne by the consumers of those goods and services. Because energy is a

vital commodity for economic activity and daily survival, consumers have a great deal of difficulty reducing their energy consumption in the short run. They must pay the price and reduce their consumption of other goods and services. In large measure, this process is the cause of the recessionary impact that follows in the wake of rising energy prices.

This process is also the cause of the very regressive impact of the fee and its associated energy price increases. As a general rule, because energy is a vital necessity, it is true that the lower a family's income is, the larger the proportion of income that the family is forced to spend on energy. Therefore, the burden borne by lower income Americans due to any energy price increase tends to be disproportionately high, when expressed as a percentage of income. This general rule is true of oil price increases. Thus, the import fee will be regressive in its general impact on the distribution of wealth and welfare in society.

In addition to the fact that energy price increases tend to be regressive in and of themselves, one must also recognize that the possible imposition of the import fee is closely associated with the deficit and that the deficit is closely associated with the tax cuts contained in the Economic Recovery Tax Act of 1981. These tax cuts, which were extremely regressive in their impact on low and middle income households, are in large part responsible for the intolerably high budget deficit.

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48

In a frantic effort to reduce the deficit, the same policy-makers who created the regressive tax cuts are threatening to undermine social equity even further by imposing a regressive oil import fee. In comparison to the distribution of the benefits of those tax cuts, the distribution of burdens associated with the oil price increase resulting from the imposition of an import fee are monstrously regressive. Table 3 presents an overview of those equity impacts.

With respect to the recent tax cuts, the impact of the fee can be described as follows:

- o The lowest income group (the 22.5 percent of the population earning less than \$10,000 per year) will have almost two-thirds of its tax cuts erased by the fee and its associated price increases.
- o The lower middle group (24.8 percent of the population earning between \$10,000 and \$20,000 per year) and the middle income group (35.2 percent of the population earning between \$20,000 and \$40,000 per year) will lose about one-third of their tax cuts.
- o The upper middle class (16.3 percent of the population earning between \$40,000 and \$80,000 per year) will lose less than one-sixth.
- o The wealthy (1.2 percent of the population which earns more than \$80,000) will lose none at all, because they benefit from increased oil company profits.

We can look at the fee from another point of view. If we compare the distribution of the sum of gross revenues to be gained by the import fee to the distribution of an equal sum of revenues lost due to the recent individual and business tax cuts, we discover the full magnitude of the

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Table 3

SUMMARY OF THE EQUITY EFFECTS OF THE IMPORT FEE

Income Group	% of Population ^a	% of Income ^b	% of Burden the Import Fee & Associated Price Increases ^c	Burden of Import Fee & Associated Price Increases as % of Tax Cuts ^d	Dollar Impact of Tax Cut Equal to Oil Price Related Revenue Increase ^e	% of Income Taxes Paid ^f
Lower Income (less than \$10,000)	22.5	6	8.9	-45.4	-1.0	} 12.4
Lower Middle Income (\$10,000-\$20,000)	24.0	13.9	18.4	-34.0	-1.28	
Middle Income (\$20,000-\$40,000)	35.2	48.1	51.6	-30.9	-3.0	42.6
Upper Middle Income (\$40,000-\$80,000)	16.3	26	24.4	-16.3	+ .98	} 44.8
Wealthy (\$80,000+)	1.2	6	(3.0)	+3.2	+4.24	

Sources:

^aCongressional Budget Office, Effects of Tax and Benefit Reductions Enacted in 1981 for Households in Different Income Categories (Washington, D.C., February 1982), Summary Table 1, p. iv.

^bBureau of the Census, Money Income of Households in the United States: 1979, Current Population Reports, Consumer Income Series, p. 60, No. 126 (Washington, D.C., 1981), Table 5, p. 3. Projected to 1982.

^cCCEA calculations, see text.

^dCongressional Budget Office, Effects of Tax, personal tax cuts only, based on 1983 only. The use of the average annual benefit for the three years 1982-1984 leads to virtually identical results.

^eJoint Economic Committee of the Congress of the United States, Impact of the 1981 Personal Income Tax Reductions on Income Distribution (Washington, D.C., December 23, 1981), Table 2, p. 33 (Joint returns only).

421

equity impact of the combined tax policy. We find that the combination of the two tax policies -- tax reduction here, tax increases there -- is nothing less than a tax shell game which represents a massive income transfer program whereby the upper middle and wealthy income groups gain at the expense of everyone else.

- o The richest 1.2 percent of the population will end up about \$4 billion better off and the next richest 16.3 percent of the population will end up \$1 billion better off.
- o The low income and lower middle income groups each will be about \$1 billion worse off.
- o The middle income group will be \$3 billion worse off.

With respect to general equity, we conclude the following:

- o The low income and lower middle income groups will pay a disproportionately larger share of the price increases than higher income groups.
- o The middle income group will pay roughly in proportion to its share of income.
- o The upper middle income group and the wealthy pay much less than their share of income.

With respect to general tax burdens in society:

- o The low income and lower middle income groups will pay almost twice as much of the additional revenues than they would have paid if those revenues had been raised through income taxes.
- o The middle income group will pay roughly the same proportion as they would have if the revenues had been raised through income taxes.
- o The upper middle and wealthy income groups will pay one-third less than if the revenue have been raised through income taxes.

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Regardless of how the burden of the fee and its associated price increases is viewed, it is grossly inequitable to the poorest four fifths of the population.

F. The Fallacy of an Import Fee as
National Security Policy

There is a side issue associated with the fee that may obscure a careful examination of its energy, economic and equity impacts. Although the import fee has been discussed and gained some support in the context of negotiations over budget deficits, it would actually be proposed and implemented in the guise of a national security measure. There must be considerable chagrin in the White House when it faces the prospect of using the Trade Expansion Act powers to impose the fee as a national security policy. The Reagan Administration vetoed the Standby Petroleum Allocation Act and gutted every major national conservation program on the basis of the belief that the free market is the only effective way to handle the energy problem -- a problem which, incidentally, the Administration has repeatedly declared not to be much of a problem anymore. The Administration will, therefore, have a hard time justifying intervention in the marketplace in such a massive way as a 20 percent tariff on imported oil in the name of national security.

Nevertheless, there are those who honestly believe that we have a serious national energy security problem and that an import fee is an intelligent response to that

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problem. CECA/RF agrees that there continues to be a significant national energy problem. However, we do not believe it is simply an import problem and we do not believe that an import fee is an effective response.

We will not examine the issue of national energy security in detail in this report, primarily because we do not believe national energy security policy should be decided as part of the budget deficit battles. However, because the national energy security issue may detract from a careful analysis of the import fee on the basis of what it truly is, bad energy policy, bad economic policy, and bad social policy, we must deal with the security issue briefly. We are convinced that the fee is bad national security policy. To the serious students of national energy security policy we pose the following questions:

1. Is the energy problem simply an import problem?

If the problem is simply OPEC, then a fee becomes a likely candidate for a response. But, if a significant part of the problem resides in the structure of the domestic industry, then an import fee may not make much sense -- indeed, it may even exacerbate the problem in some ways. For example:

- o In the short term it may have the perverse effect of inducing a reduction of private stocks of oil.
- o In the long term, it may reinforce the non-competitive structure of the industry by propping up the already inflated value of its commodity, as well as providing more fuel for the fires of corporate takeovers.

If domestic companies have the capacity to manipulate supplies, stocks and flows -- and there is at least some evidence that oil company behavior prior to the fall of the Shah of Iran seriously increased our vulnerability -- then an import fee may not even be part of the solution.

2. Has the structure of the world oil market changed sufficiently to require a rethinking of the national energy security problem?

Even if one believes that the energy problem of the 1970s was an import problem, one should still ask whether the energy problem of the 1980s will be an import problem.

- o The rapid expansion of non-OPEC production capacity and the declining energy intensity of output in the industrialized nations of the West may represent fundamental structural changes in the market.
- o The fact that prices have actually declined for the first time in a decade may only be the surface manifestation of more deep-seated change that calls for a careful reassessment of the situation.

3. Is an import fee an effective response to an import problem?

Even if one concludes that the national energy security problem of the 1980s will be an import problem, one must ask whether an import fee is an effective response. Decontrol has driven the price of domestic oil up by over three hundred percent in three years. The quantities of energy at stake by imposing an import fee on top of these price increases are, in fact, very small.

The Congressional Budget Office estimates at best an import savings of between 200,000 and 300,000 barrels per day through demand side conservation from a \$5/bbl fee. It sees no supply side response. The Department of Energy had earlier projected a total savings of between 150,000 and 400,000 barrels per day. These numbers are miniscule compared to productive capacity.

- o This represents less than 2 percent of the non-OPEC free world production and even a smaller proportion of non-OPEC productive capacity.
- o This represents less than 3 percent of OPEC's currently underutilized capacity.
- o This represents less than 15 percent of the current world excess of supply.

Given the relatively small effect on world oil supply that the fee will have, one may question its effectiveness.

4. Is an import fee the best choice we can make?

Even if one believes that the 150,000 to 400,000 bbl/d savings are important as a strategic response, one must ask whether this is the best policy choice to enhance national energy security. We do not buy any and every weapons system to enhance national military security, and we ought not buy every and any policy option to enhance national energy security.

We must operate in a world of limited resources and difficult choices. To waste our national resources on an ineffective policy option when many more effective options

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are available may be as bad as not spending resources at all: Misspent resources create a false sense of security (the construction of the Maginot line by the French between the first and second world wars is just one particularly relevant example). The number of available alternatives preferable to the fee is impressive:

- o The energy savings potential of federal energy conservation programs recently dismantled by the Reagan administration almost certainly equals the potential of the fee, at a fraction of the cost.
- o As the instantaneous response to a crisis, the Strategic Petroleum Reserve already contains about 2.5 times more oil than the import fee will save next year. We could add six times as much oil per year to the reserve at the same cost as the fee.
- o The National Petroleum Council, the American Petroleum Institute and the Department of the Treasury have identified short term measures that would produce ten times as much energy savings on a short term strategic response basis, the total cost of which would probably be smaller.
- o The Solar Energy Research Institute, the National Academy of Sciences and Resources for the Future have identified mid and long term strategies that would yield savings at least ten times as large.

5. Are the economic and social costs of the policy bearable?

Even if the policy is found to be effective and competitive with other available options, are we willing to pay the price? There are some risks we are willing to take as a nation because the costs of reducing them are too high. As noted above, in order to save the 150,000-400,000 barrels per day of imports, we will pay roughly \$20.6 billion in increased oil costs, reduce GNP by one percent and increase

the unemployment rolls by roughly 300,000 to 350,000 people, in addition to further skewing the national distribution of purchasing power. Is it worth it?

To put this question most dramatically, let us note that over the last three years the easiest way to reduce oil imports has been to increase unemployment. Figure 2 shows the very strong relationship between unemployment and imports. As a rough rule of thumb, we can say that for every one million persons laid off, imports drop by roughly three-quarters of a million barrels. The econometric analysis shows that this relationship would hold for the import fee as well. Yet we categorically reject a strategy that would raise unemployment to 13 percent just to end oil imports altogether. The cure would be worse than the disease.

We do not presume to have definitive answers to all of these questions. But, they are serious questions and we are convinced that:

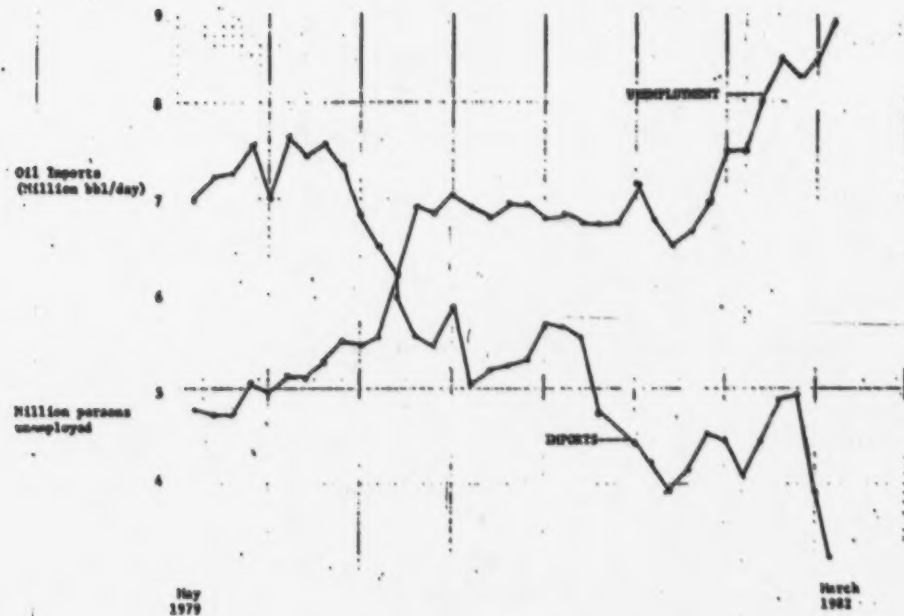
- o Imports alone are not the problem,
- o The import fee is not the simple solution, and
- o Above all, grasping at an oil import fee as the only strategic energy security policy that can be slipped through in the next few years and doing so under the guise and in the heat of budget considerations may do more harm than good.

We agree that it is critical to work out an effective national energy security strategy, but in the midst of budget wars this is not the time, the place or the manner in which to do so.

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FIGURE 2
CHANGES IN UNEMPLOYMENT AND CHANGES IN IMPORTS



SOURCES: President's Economic Report, 1982
Monthly Energy Review (selected issues)

G. The Tragedy of the Import Fee as
Budget-Balancing Policy

Perhaps the reason that the certain failure of an import fee as energy, economic, equity and security policy can be so easily overlooked by its promoters lies in the fact that the oil import fee is actually being considered with almost no reference to energy, economics, equity or security. It is a budget balancing tool and many who have until very recently rejected the fee out of hand have suddenly changed their minds in the context of budget balancing. This is the fee's ultimate irony.

At first glance, the fee presents a seductive illusion. It appears to be a very attractive option to those who are grappling with massive budget deficits. It looks like a big ticket revenue raiser that taxes things, not people. Because it only reverses a downward trend in prices instead of raising already increasing prices, it may seem to portend little ill with respect to the economy and inflation. Nothing could be further from the truth and herein lies the ultimate tragedy of the import fee. The oil import fee is far from an innocuous budget balancing trick.

When one analyzes the inner workings of the fee, it proves to be a cruelly inequitable tax that is inflationary, recessionary and potentially disastrous for the economy.¹⁷ And, worst of all for those who justify support for the fee on the basis of its budget-balancing potential, the oil import fee is an extremely inefficient way to raise a relatively small sum of revenue.

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In a sense, the import fee is a perfect modern analogue to the ancient Trojan horse. That fabled animal was the quintessence of illusion -- an apparently happy conclusion to a time of troubles, it led the unwitting who celebrated its arrival to utter defeat. Just as the Trojans would have done well to examine the bowels of the beast before they wheeled it within the walls of their city, we believe that every aspect and detail of the import fee must be subjected to the utmost scrutiny before it works its way into our national budget assumptions.

Once such an analysis is undertaken, we believe that careful policy makers will heed the advice given in Virgil's Aeneid: "to throw it into the sea, to burn it up with fire, to cut it open."¹⁸ The rational policy-maker will reach this conclusion not only because the fee is stagflationary and grossly inequitable, but, in the midst of the longest, deepest recession since the great depression of the 1930s, it is downright suicidal. Recalling much more recent history will lead policy-makers to recognize that attempting to close the budget deficit by dramatically reducing the purchasing power of the vast majority is the worst brand of Hooverist economics.

Unwittingly, although by now we should know better, budget balancers end up chasing their own tails when they create inflationary, regressive reductions in purchasing power, such as those associated with the fee, in a futile attempt to reduce the deficit. In the current context, where

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inflation is already being fought with tight monetary and fiscal policy, the introduction of an oil price shock can have multiplicative effects. It may reinforce the commitment to restrictive policies compounding and prolonging the fee's recessionary impacts and ultimately redoubling the search for more budgetary balancing. In this context, the circles that the budget balancers run can turn into long spirals descending from recession into a profound depression.

H. Conclusion

For these reasons, we believe that the oil import fee should be rejected out of hand. It is bad energy policy, senseless economic policy, ineffective budget policy, disastrous social equity policy and dubious national security policy. The remainder of this report documents the economic, revenue, equity and efficiency analyses underlying these conclusions.

Chapter II states the basic issues, reviews simple empirical evidence and the theoretical explanation of the link between energy prices and changes in the level of economic activity. Chapter III describes CECA/RF's base case assumptions underlying our estimates of the likely size and cost of the fee. Chapter IV presents our derivation of estimates of the impact of the fee based on a study of the response of the economy to the energy price shocks of the 1970s and compares them to the recent econometric simulations of the impact of the fee conducted by others. Chapter V discusses the gross and net revenues impact of the fee. Chapter VI reviews the equity impact of the fee. In Appendix A we analyze the impact of the fee on the efficiency of the energy markets.

Mr. MOFFETT. Mr. Montgomery, your statement will be included in the record in its entirety.

STATEMENT OF W. DAVID MONTGOMERY, SENIOR FELLOW, RESOURCES FOR THE FUTURE, ACCOMPANIED BY DOUGLAS R. BOHI, SENIOR FELLOW, AND HARRY G. BROADMAN, FELLOW

Mr. MONTGOMERY. Thank you. I will try to summarize briefly a few points from the statement.

Since this is a controversial issue, let me begin by mentioning that Resources for the Future is a nonprofit tax exempt research organization which as an institution takes no position on policy issues. We appear here at your invitation and represent only ourselves.

To those of us who follow the current debate in the newspapers the question of an oil tariff or import fee seems to be raised largely in the context of alternative fiscal measures. Its advantages are discussed in terms of the budget deficit, and its disadvantages are discussed in terms of the burden placed on groups, regions, or industries that would pay a disproportionate share of the tax.

But an oil tariff is also an energy policy measure. It is in this regard that our research has inquired into its advantages and disadvantages. We believe that the ability of an oil tariff to promote energy policy goals should be considered along with budgetary and equity issues.

Let me begin by laying out a brief train of reasoning in regard to the import fee.

Our research has been concerned largely with the question of whether the market determined price of oil would lead to levels of oil imports, production and use that are in the Nation's best interests. We have examined and weighed a number of factors that have led us to the conclusion that the cost to society of importing an additional barrel of oil is greater than the price paid.

From this conclusion it also follows that the United States is consuming too much oil, and producing too little, and moving too slowly toward reliance on alternative tools. With this part of the argument I suspect there is general agreement.

In order to redress the imbalance, we believe that a greater incentive is required for conservation and domestic energy production than is provided by the world oil price. And a tariff on imported oil could provide that greater incentive in a properly uniform way to all producers and consumers. This is the basic outline of our argument.

We have had to wrestle with a lot of advantages and disadvantages and questions about the tariff in reaching this conclusion. In fact, some of the things we have written have been interpreted to imply that we have been opposed to the tariff. And we have found ourselves in agreement with Mr. Cooper that there are a number of areas of energy policy that a tariff will not address effectively. Nevertheless, we believe that an oil tariff does represent sound energy policy, and that a level of \$5 a barrel can be justified.

Let me touch on a few of the points that go into this train of reasoning in more detail.

I would say there are two principal reasons for believing that the price of oil does not accurately measure its cost to society. They are the influence that U.S. imports have on the world oil price, and the vulnerability to oil supply disruption that is created by our economic dependence on oil.

On the first, the events of the past few years, I think, provide clear evidence of the link between the demand for imported oil and the world oil price. Perhaps I should not go more deeply now into the question of what effect changes in imports might have in the current market situation, but we would be happy to do that in the questions.

In any event, if there is a relationship between the level of imports and the world oil price, eliminating one barrel of our oil imports will reduce our total import bill by an amount greater than the price of that barrel. That means there is a gap between the private incentive for reducing imports, for producing or conserving energy, and the social benefit.

In a world where the market price of oil determines behavior no one will be willing to spend more to produce an additional barrel of oil than its price. No one will be willing to forego the use of a barrel of oil if its value in use is greater than the price at which oil can be obtained.

If the cost to society of a barrel of imported oil exceeds its price, oil production and conservation will be inadequate.

This points out that there is a difference between the inefficiencies associated with holding the domestic price of oil below the world oil price, and the cost of going above the world oil price. Certainly we can go too high above the world oil price, put on a tariff too large. But moving to some degree above the world oil price, I think, means moving in the proper direction.

There are lots of uncertainties about the relation between import levels and the world oil price. We have no reliable statistical estimates of what the relation between world oil supply and price is even in the most tranquil of markets. More disturbing, there are questions about how oil exporters might react to any action we would take to reduce imports. They might cut back their production to meet our reduction in oil demand, thereby preventing a fall in price or even worse, they might retaliate in a way that would push the world price above the pretariff level. In either of these cases we would be bearing the cost of additional conservation and production without compensating benefits in the size of our import bill.

The second reason why we might believe that the cost of oil imports is greater than their price is the continuing insecurity of oil supply. I would put a relatively narrow interpretation on what this cost is.

An oil supply disruption would lead to a sudden jump in world and domestic oil prices. Some of the resulting costs are faced directly by individuals who pay higher bills for oil and are constrained to consume less energy. And presumably it is in their own interest to take those costs into account in their decisions.

But in addition to those costs, we will suffer a loss in GNP because nonoil markets cannot adjust efficiently to an oil price shock. Measuring these macroeconomic costs is extremely difficult, and it

is likely they are more closely related to the level of total consumption to the level of oil imports. But they do indicate another wedge between the benefits that individuals see and the price they pay.

Although oil conservation would reduce the macroeconomic costs of oil supply disruptions, no individual has an economic incentive to take those costs into account in making a consumption decision. The contribution of oil use to economic vulnerability is like its contribution to air pollution: everyone suffers, but no one has an adequate incentive to take individual action.

Let me turn to the question of whether a tariff is an appropriate energy policy instrument to deal with this gap between private incentives and social benefits. I think it is. In regard to the relation between import levels and the world oil price, any source of additional oil production and any means of reducing oil consumption will have the same effect of reducing oil imports and hence deserves the same incentive.

By providing a market incentive for additional conservation and production of oil and alternative fuels, the tariff will seek out the most cost-effective means of reducing imports in a uniform way throughout the economy, not just those which are targeted by particular programs or particular narrowly defined taxes.

In this sense we think that the market can work.

It is not true that the world oil price is the right price for us to be facing. We think there is an adjustment under which the market can be allowed to work to choose the most efficient ways of responding.

How large a tariff then might be justified? Our research has included a survey and analysis of attempts to measure this gap between the costs to society and the price of oil.

These findings are contained in one of our discussion papers by my colleague Harry Broadman, which I would be pleased to submit separately for the record.

A \$5 fee is at the low end of the range of estimates we have seen, and it could be justified on the basis of the effect of import reduction on the world oil price alone. We believe that it makes sense to keep a tariff at this conservative end of the range of estimates.

Uncertainty about oil exporters response and about how large a reduction in oil prices can be achieved exists. Moreover, sudden imposition of a large tariff, as has been pointed out already today, can create a domestic price shock similar in nature if not in size to that resulting from an oil supply disruption.

Keeping the tariff small, at least initially, can help avoid that shock.

Finally, we prefer a conservative level for an import fee because we believe its primary benefit is in putting downward pressure on the world oil price; that other measures might better address the problem of oil vulnerability.

Our evaluation of the arguments leads us to the conclusion that the tariff is indeed warranted as an energy policy measure. But we recognize that energy policy considerations are only one part of the decision. Who will benefit from and who will pay the tax also matter.

We would simply suggest in the context of the current budget discussion, compared to taxes which introduce disincentives and

market distortions, the import fee offers some potential benefits for the economy as a whole. It is a matter for political judgment whether adverse distributional consequences can be offset through adjustments in other taxes and programs, whether the harm to some is worth the potential benefits to all.

Thank you.

[The statement of Messrs. Bohi, Broadman, and Montgomery follows:]

Statement of

Douglas R. Bohi
Harry G. Broadman
W. David Montgomery

Resources for the Future, Inc.

Mr. Chairman and Members of the Subcommittee:.

It is a privilege to appear before you today to describe some of the results of the research that we have been conducting on the subjects of oil prices, import policy and energy security. We are all members of the research staff in the Center for Energy Policy Research at Resources for the Future. Resources for the Future is a non-profit, tax-exempt research organization which, as an institution, takes no position on policy issues. We appear at your invitation and represent only ourselves.

SUMMARY

To those of us who follow the current debate in the newspapers, the question of an oil tariff or import fee seems to be raised only in the context of comparing alternative fiscal measures. Its advantages are discussed in terms of the budget deficit, and its disadvantages are discussed in terms of the burden placed on groups, regions, or industries that would pay a disproportionate share of the tax. But an oil tariff is also an energy policy measure. It is in this regard that our research has inquired into the advantages and disadvantages of an oil tariff. We believe that the ability of an oil tariff to promote energy policy goals should be considered along with budgetary and equity issues.

Our research has been concerned largely with the question of whether the market determined price of oil will lead to levels of oil imports, production and use that are in the nation's best interest. Research on this general subject at Resources for the Future, and by some of us, dates back to at least 1973. The specific projects on which the three of us have worked began about one and one-half years ago. During this time we have examined and weighed a number of factors which have led us to the conclusion that the cost to society of importing an additional barrel of oil is greater than the price paid. From this conclusion it also follows that the United States is consuming too much and producing too little oil and moving too slowly toward reliance on alternative fuels. In order to redress the imbalance, a greater incentive is required for conservation and domestic energy production than is provided by the world oil price. A tariff on imported oil could provide that greater incentive in a properly uniform way to all producers and consumers.

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This is the basic train of reasoning that has led us to conclude that an oil tariff represents sound energy policy. However, a tariff is neither wholly good nor wholly bad; there are advantages, disadvantages, and uncertainties that need to be weighed.

We will try to deal with these issues more fully by:

- Describing more deeply the reasons why the price of imported oil is not a good measure of its social cost;

- Indicating to what extent a tariff can serve to redress the imbalance; and

- Analyzing the information that is available on how large a tariff is appropriate.

Throughout, we will indicate where the most contestable issues and key uncertainties arise.

PRIVATE VERSUS SOCIAL COSTS OF OIL IMPORTS

There are two principal reasons for believing that the price of oil does not accurately measure its cost to society. They are the influence that U.S. oil imports have on the world oil price, and the vulnerability to oil supply disruptions attendant to our economic dependence on oil.

The Relation Between Import Levels and Oil Prices

The events of the past few years provide clear evidence of a link between the demand for imported oil and the world price. During 1979 and 1980, interruption of oil exports from Iran and Iraq created excess demand for oil, and oil prices rose until that demand was choked off. Had it been possible to restrain oil import demand through other measures, oil prices would not have risen so high.

More recent events have demonstrated that declining oil demand also can force the world price to fall. OPEC has been unable to maintain the high prices charged in 1979, and in its recent Vienna meeting took unprecedented steps to try to stem the tide. Lower levels of oil import demand should help to maintain the pressure on the world price.

Analytical studies of the world oil market make the same point in the long run. The most comprehensive recent study is one conducted by the Energy Modelling Forum at Stanford University. That study has concluded

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that under many alternative assumptions about the motivations of oil exporters, shifting to a lower level of oil imports over time will have an effect on the world oil price beneficial to the United States.

Private Incentives and Social Costs. The total amount that we pay for oil imports is equal to the world price times the quantity of imports. But if lower imports produce a lower world price, eliminating one barrel of imports reduces the total import bill by an amount greater than the price of that barrel. This point has been made by many analysts, but a simple numerical example will illustrate this point.

Suppose the U.S. oil market is in equilibrium with imports of 5.5 MMB/D and the world oil price is \$34.00 per barrel. If a reduction in imports of 500,000 B/D lowers the world oil price by \$.50, the total U.S. oil import bill will decline from \$187 million to approximately \$167 million per day. This decline in the import bill would imply that, to the nation as a whole, the benefits derived from doing without each of the 500,000 barrels is \$40.00. However, the direct savings to an individual from reducing consumption of each of these barrels is only \$33.50, the market price. The difference of \$6.50 between the benefits to society and to individuals from this reduction in oil imports constitutes an element of a premium on imported oil.

More generally, the effect of imports on the world oil price creates a gap between the private incentive for reducing imports and the social benefit. In a world where the market price of oil determines behavior, no one will be willing to spend more to produce an additional barrel of oil than the price that oil would command; and no one will forego the use of a barrel of oil if its value in use is greater than the price at which oil can be obtained. If the cost to society of a barrel of imported oil exceeds its price, oil production and conservation will be inadequate. Some additional production or conservation would be desirable, and would entail a cost less than the resulting savings on payments for oil imports.

Uncertainties. Key uncertainties about the size of the gap between private and social cost of oil imports derive from an inadequate understanding of the world oil market. To estimate the size of the gap requires knowledge of how world oil supply responds to a change in the world price; and no truly reliable estimates of that relation exist.

More disturbing is the question of how oil exporters might react to an attempt to further reduce import levels. If oil exporters cut back production to match a reduction in oil demand, they could prevent a fall in price. Then the United States would incur costs of additional conservation and domestic production of oil and alternative fuels without compensating benefits in the size of the import bill.

Worse, there is the risk that a tariff might provoke retaliation of a kind that would push the world oil price above its pre-tariff level. Such would be the case if action to reduce imports made the clumsy (OPEC) cartel a more co-ordinated and effective body.

At this point, it is useful to recognize that any gains the United States derives from limiting import demand are achieved at the expense of the oil exporting countries. The tariff is a beggar-thy-neighbor policy and, as history demonstrates, its use may trigger trade wars in which all countries lose. Thus, to exercise our buying power in oil markets requires some additional justification. Two points seem most important:

- 1) OPEC has already made the first move, through its attempts to use its market power to drive up the world price of oil.
- 2) The insecurity of oil supply, and its pervasive importance in an industrial economy provide good domestic reasons for reducing oil imports.

Oil Vulnerability and the Social Cost of Imports

The continued insecurity of oil supply provides a second reason for believing that the social cost of imported oil is larger than its price. Although the risk of another oil supply disruption may seem small today, a large proportion of the world's oil supply still comes from the perpetually unstable region of the Persian Gulf. A random event in the Middle East can suddenly convert a surplus market into a shortage.

An oil supply disruption like those of the past would lead to a sudden jump in world and domestic oil prices. A large portion of the economic cost of the disruption would appear in the form of larger total payments for oil imports. Another cost would be the value of uses of oil that have to be foregone because of the lower supply and higher price of imports. In addition to these direct costs, an oil supply disruption will cause losses

in aggregate income and output because non-oil markets cannot adjust efficiently to the oil price shock. Because of various institutional rigidities, prices and wages will not respond immediately to an oil price shock and reallocate resources. Markets will be in temporary disequilibrium as excess supplies and demands develop, and the economy will operate less efficiently as a result. Bottlenecks will occur in some markets and excess capacity will develop in others. Total employment will fall, while employed resources will be used less efficiently. All of this amounts to a reduction in aggregate output because of an oil supply disruption, and the reduction is in addition to that directly related to the consumption of imported oil. Moreover, the losses in output cannot be averted by using monetary and fiscal stabilization policies, except insofar as the level of aggregate demand is reconstituted to avoid leakage from the income stream.

Measuring these costs is extremely difficult. Moreover, it is likely they are more closely related to levels of oil consumption than to levels of oil imports. The more important oil is in the economy, the greater will be the costs and risks of a disruption. But the macroeconomic costs we just described are related to the level of total oil consumption, not to the level of imports. An oil price shock would cause the losses in output and employment associated with these factors whether the United States were a net oil importer or exporter.

Although oil conservation would reduce the macroeconomic costs of oil supply disruptions, no individual has an economic incentive to take those costs into account in making a consumption decision. The contribution of oil use to economic vulnerability is like its contribution to air pollution: everyone suffers, but no one has an adequate incentive to take individual action.

IS A TARIFF AN APPROPRIATE ENERGY POLICY INSTRUMENT?

Having looked at some of the reasons why the world price of oil is an inadequate measure of the cost of oil imports, we now turn to the question of whether a tariff is the appropriate policy instrument to remedy the situation.

One portion of the gap between private incentives and social benefits of import reduction arises from the effect of imports on the world oil

price. Any source of additional oil production, and any means of reducing oil consumption, will have the same effect of reducing oil imports and hence deserves the same incentive. By providing a market incentive for additional conservation and production of oil and alternative fuels, a tariff will seek out cost-effective means of reducing imports in a uniform way throughout the energy economy.

A tariff will be more efficient than any other combination of policies that achieve the same import reduction but which fail to equate the cost of additional conservation and domestic oil production in all transactions throughout the economy. The level of imports that a tariff will bring about depends on individual comparisons between the costs and benefits of specific actions to reduce oil consumption or to increase production of oil and alternative fuels. A homeowner may find that the savings from maintaining a lower indoor temperature in winter will outweigh the resulting discomfort, or may choose to invest in insulation. A factory may invest in more efficient machinery. An oil producer may work over a well and increase its production rate, or a wildcat explorer may turn attention to a new field. The higher domestic price of oil caused by the tariff will encourage obscure and unexpected actions as well as commonplace and noticeable ones. Other measures--gasoline taxes, specific conservation incentives, subsidies to oil and alternative fuels production, etc.--are not as efficient as a tariff because they are not as broadly based and uniform.

A tariff has a complementary effect of helping to reduce economic vulnerability to a disruption. However, increasing domestic oil production may not be as effective in reducing oil vulnerability as is energy conservation; and alternative measures such as the Strategic Petroleum Reserve can also work efficiently to reduce disruption risk. Thus it is questionable whether a tariff should be set at a level much higher than that justified by the effect of import demand on the world price. Nevertheless, the existence of disruption risks reinforces the case for having a tariff at least that large. We will return to this point after reviewing some estimates of the social cost of oil imports.

HOW LARGE A TARIFF?

Our research has included a survey and analysis of attempts to estimate the difference between the true cost to society of oil imports and their price.

These estimates range from \$2 to \$124 per barrel. Arguments in favor of estimates at the high end of the range are, in our opinion, conceptually flawed. In addition, to come up with an estimate much above \$10-\$15 per barrel, it is necessary to put considerable weight on the ability of oil import reduction to reduce vulnerability to oil supply disruptions. These findings are contained in one of our discussion papers (by Harry Broadman) that we would be pleased to submit separately for the record.

We understand that current budgetary discussions are of an oil import fee of \$5 per barrel. A fee of that size is supported by most estimates of the value of import reduction. Indeed, a \$5 fee is at the low end of the range of estimates, and could be justified on the basis of the effect of import reduction on the world oil price alone.

We would add the further observation that in the current state of the world oil market, OPEC is having great difficulty cutting back production sufficiently to defend the current price. Thus the prospect of retaliation to a tariff seems to us less likely than in past situations of tight markets, and one of the greatest risks involved in imposing a tariff is, for now, more remote.

Nevertheless, we believe that it makes sense to keep a tariff at the conservative end of the range of estimates. Uncertainty about oil exporters' response, and about how large a reduction in oil prices can be achieved, remains. Moreover, sudden imposition of a large tariff can create a domestic price shock, similar in nature if not in size to that resulting from an oil supply disruption. Keeping the tariff small, at least initially, can help avoid that shock.

Finally, we prefer a conservative level for an import fee because we believe that its primary benefit is in putting downward pressure on the world oil price and that other measures may attack the problem of oil vulnerability more efficiently. The Strategic Petroleum Reserve, as it becomes filled, will offer greater protection against disruptions at lower cost. Although the potential of the Reserve to insulate the economy from oil price shocks reduces the need for a large import fee, the benefits of a fee in the \$5 to \$10 range are enhanced by its ability to lower the cost to the government of oil placed in the Reserve. In this way, if not directly, a fee would help to finance the Reserve, and at the same time, by reducing import dependence, reduce its necessary size.

An excise tax, on domestic as well as imported oil, does not work as well as a tariff to incorporate in private incentives the effect of import reductions on the world price. An excise tax will not encourage additional domestic production of oil, and therefore will not drive down imports as effectively as an import fee of the same size.

However, to repeat our earlier argument, we do not believe that a tariff should be set at a level larger than that justified by its downward pressure on world oil prices. To deal with disruption risks as well, it would be better to accompany the tariff with an excise tax than simply to increase the tariff.

CONCLUSIONS

In order to come to a reasoned judgment about the wisdom of a tariff it is necessary to weigh the significance of a number of uncertain factors. To choose a level for the tariff also requires a balancing of the costs and benefits of additional import reduction. Our evaluation of the arguments leads us to the conclusion that a tariff is indeed warranted as an energy policy measure. In our view, the uncertainties about supply and demand behavior do not negate the arguments for a tariff but do constrain the recommended size of the tariff to a conservative magnitude. A \$5 per barrel tariff is at the conservative end of the range of estimates of the value of reducing oil imports.

However, we recognize that energy policy considerations are only one part of the decision on an oil import fee. Who will benefit from and who will pay the tax also matters. We would suggest that compared to taxes which introduce disincentives and market distortions, the import fee offers benefits for the economy as a whole. It remains a matter for political judgment whether adverse distributional consequences can be offset through adjusting other taxes or programs, and whether the harm to some is worth the potential gains for all.

Mr. SYNAR. Mr. Sweeney.

**STATEMENT OF STEVE J. SWEENEY, SENIOR VICE PRESIDENT,
BOSTON EDISON CO.**

Mr. SWEENEY. Mr. Chairman, my name is Stephen J. Sweeney, senior vice president, Boston Edison Co., and I am appearing here today on behalf of both the company and the Edison Electric Institute (EEI), of which we are a member. EEI member companies serve 99 percent of all customers of the investor-owned segment of the industry and 77.5 percent of all users of electricity in the United States.

I appreciate the opportunity to show how the imposition of any extra costs on imported oil would not only be a serious mistake, but also a hidden tax on the American consumer. Experience over the past decade has taught us the dangers of ill-conceived attempts to substitute governmental fiat for reliance on consumers' self-interest and in the use of energy pricing policy as a means to achieve social and political ends.

Now that we have made substantial progress toward mitigating our national problem of excessive dependence on imported oil through greater reliance on market forces, the current import fee proposal, which might have made sense as a counterbalance to the now-abandoned oil price controls, is wholly inappropriate.

Proponents of the import fee claim that it would serve both to further reduce import dependence and to make a substantial contribution toward reducing the Federal budget deficit. Analysis of these claims shows them to be greatly exaggerated. An examination of the negative impacts of the proposed fee on the national economy as a whole shows that little would be gained but much lost by an import fee, particularly during a period of recession.

I will deal in broad terms with the more general issues, and focus particularly on the problems faced by the oil-dependent electric utilities and their customers, who must ultimately pay the bills.

It is extremely questionable whether an import fee is necessary for national security at a time when imports are down sharply, our strategic petroleum reserve is being filled, and there are large worldwide surpluses of oil.

The return of a free market in oil is serving the consumer well. Domestic oil development is up sharply, the total annual number of wells drilled more than tripled since 1971, and prices have been falling.

In 1981 the highest price we paid in New England, 1-percent imported oil, was \$36.51. Last week we paid \$27.75. The free market is working and now is not the time for Government intervention into the market that is working well without it.

U.S. consumers are clearly wedded to the path of conservation, and even without an import fee, prices are high enough to keep them on this path. OPEC production is already so low compared to capacity that vulnerability to a supply disruption has declined. We should therefore pay careful attention to the purely economic effects of the import fee.

These effects include significant increases in the inflation and unemployment rates, and a decrease in the rate of real GNP growth, all of which can only be regarded seriously when the economy is already in recession.

More specifically, we see an oil import fee reducing the competitiveness of U.S. industry in world markets. Domestically, increased oil prices will adversely affect agricultural producers and energy interest industries such as petrochemicals, wood, and paper, while the automobile industry will be struck yet another body blow.

In general terms, consumers of oil with few alternative sources of energy, such as those in the Northeast who have already suffered disproportionately to those more fortunately situated, will be treated inequitably once more * * * this time at the hands of the U.S. Government, rather than OPEC.

I would like now to turn to my own industry, electric utilities, and particularly to those regions such as New England, New York, California and Florida, who rely to a great extent on low-sulfur fuel oil for electric generation. This dependence historically came about because of oil's lower cost in the 1950's and 1960's, and in its ability to more readily meet environmental constraints, compared to coal.

When the price of imported oil began rising rapidly, utilities in these regions made valiant attempts to turn to alternative sources, notably nuclear power. For a number of reasons, of which problems with Government regulations were by no means the least significant, a substantial degree of oil dependence remains and cannot be reduced, except where generating units are coal capable.

Although utility consumption of oil has dropped dramatically since the late 1970's, 350 million barrels of residual oil was still burned by utilities in 1981, and the Edison Electric Institute projects that in 1990 about 440 million barrels will be needed to generate about 7.6 percent of the Nation's electricity.

A \$5-per-barrel fee on oil imports would likely result in a similar price increase for domestic oil, and so utility customers in oil-dependent regions could be expected to pay an extra \$1.5 to \$2 billion annually in fuel costs.

For your information, I am submitting along with my comments a copy of EEI's statement on oil import fees. This provides additional background on the impact of such a fee, nationwide.

To take a specific example, customers of the Boston Edison Co. in 1981 paid an average of 4.7 cents per kilowatt hour for fuel alone in 1981. A \$5-per-barrel increase in the cost of oil would add \$75 million to our fuel bill and translate to a new fuel charge of 5.5 cents per kilowatt hour, a 17-percent increase. A typical residential consumer using 500 kilowatt hours per month would pay an extra \$4 per month over rates which are already very high compared with the national average.

In summary, an import fee would severely affect the competitiveness of American industries in world markets, and retard economic growth. Neither would it encourage additional energy conservation, since oil imports and consumer demand for oil have declined substantially.

Because of the many adverse consequences associated with an oil import fee, which I have illustrated both generally and specifically,

I commend for your approval the resolutions opposed to a fee which have been introduced in the House of Representatives by Mr. Conte and Mr. Dingell, and in the Senate by Senators Chafee and Mitchell.

Thank you, Mr. Chairman.

[Mr. Sweeney's prepared statement follows:]

STATEMENT OF STEPHEN J. SWEENEY, SENIOR VICE PRESIDENT, BOSTON EDISON CO.

Mr. Chairman, my name is Stephen J. Sweeney, Senior Vice President, Boston Edison Company, and I am appearing here today on behalf of both the Company and the Edison Electric Institute (EEI), of which we are a member. EEI member companies serve 99 percent of all customers of the investor-owned segment of the industry and 77.5 percent of all users of electricity in the United States.

I appreciate the opportunity to show how the imposition of any extra costs on imported oil would not only be a serious mistake but also a hidden tax on the American consumer. Experience over the past decade has taught us the dangers of ill-conceived attempts to substitute governmental fiat for reliance on consumers' self-interest and in the use of energy pricing policy as a means to achieve social and political ends. Now that we have made substantial progress towards mitigating our national problem of excessive dependence on imported oil through greater reliance on market forces, the current import fee proposal, which might have made sense as a counterbalance to the now-abandoned oil price controls, is wholly inappropriate.

Proponents of the import fee claim that it would serve both to further reduce import dependence and to make a substantial contribution towards reducing the Federal budget deficit. Analysis of these claims shows them to be greatly exaggerated. An examination of the negative impacts of the proposed fee on the national economy as a whole shows that little would be gained but much lost by an import fee, particularly during a period of recession. I will deal in broad terms with the more general issues, and focus particularly on the problems faced by the oil-dependent electric utilities and their customers, who must ultimately pay the bills.

It is extremely questionable whether an import fee is necessary for national security, at a time when imports are down sharply, our Strategic Petroleum Reserve is being filled, and there are large worldwide surpluses of oil. The return of a free market in oil is serving the consumer well. Domestic oil development is up sharply (the total annual number of wells drilled more than tripled since 1971) and prices have been falling.

U.S. consumers are clearly wedded to the path of conservation, and even without an import fee, prices are high enough to keep them on this path. OPEC production is already so low compared to capacity that vulnerability to a supply disruption has declined. We should therefore pay careful attention to the purely economic effects of the import fee. These effects include significant increases in the inflation and unemployment rates, and a decrease in the rate of real GNP growth, all of which can only be regarded seriously when the economy is already in recession.

More specifically, we see an oil import fee reducing the competitiveness of U.S. industry in world markets. Domestically, increased oil prices will adversely affect agricultural producers and energy interest industry such as petrochemicals, wood and paper, while the automobile industry will be struck yet another body blow. In general terms, consumers of oil with few alternative sources of energy, such as those in the Northeast who have already suffered disproportionately to those more fortunately situated, will be treated inequitably once more . . . this time at the hands of the U.S. Government rather than OPEC.

I would like now to turn to my own industry, electric utilities, and particularly to those regions such as New England, New York, California and Florida, who rely to a great extent on low sulfur fuel oil for electric generation. This dependence historically came about because of oil's lower cost in the 1950's and 1960's, and in its ability to more readily meet environmental constraints, compared to coal. When the price of imported oil began rising rapidly, utilities in these regions made valiant attempts to turn to alternative sources, notably nuclear power. For a number of reasons, of which problems with government regulations were by no means the least significant, a substantial degree of oil dependence remains and cannot be reduced, except where generating units are coal capable.

Although utility consumption of oil has dropped dramatically since the late 1970's 350 million barrels of residual oil was still burned by utilities in 1981, and the Edison Electric Institute projects that in 1990 about 440 million barrels will be needed to generate about 7.6 percent of the nation's electricity. A \$5 per barrel fee

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on oil imports would likely result in a similar price increase for domestic oil, and so utility customers in oil-dependent regions could be expected to pay an extra \$1.5 to \$2 billion annually in fuel costs. For your information, I am submitting along with my comments a copy of EEI'S statement on oil import fees. This provides additional background on the impact of such a fee, nationwide.

To take a specific example, customers of the Boston Edison Company in 1981 paid an average of 4.7 cents per kilowatthour for fuel alone in 1981. A \$5 per barrel increase in the cost of oil would add \$75 million to our fuel bill and translate to a new fuel charge of 5.5 cents per kilowatthour, a 17-percent increase. A typical residential consumer using 500 kilowatthours per month would pay an extra \$4 per month over rates which are already very high compared with the national average.

In summary, an import fee would severely affect the competitiveness of American industries in world markets, and retard economic growth. Neither would it encourage additional energy conservation, since oil imports and consumer demand for oil have declined substantially.

Because of the many adverse consequences associated with an oil import fee, which I have illustrated both generally and specifically, I commend for your approval the resolutions opposed to a fee which have been introduced in the House by Representatives Conte and Dingell, and in the Senate by Senators Chafee and Mitchell.

OIL IMPORT FEES ARE NOT IN THE INTEREST OF ELECTRICITY CONSUMERS

The Edison Electric Institute (EEI), the national association of the investor-owned electric utility industry opposes an import fee on oil or oil products. The EEI member companies serve 99 percent of all customers of the investor-owned segment of the industry and 77.5 percent of all users of electricity in the United States. The widely discussed import fee of \$5.00 per barrel on oil is inequitable, impacts most domestic and imported oil prices, raises the cost of natural gas and could cost utility customers \$1.5-\$2 billion annually. Because consumers of electricity pay fuel charges, the burden of the fee would fall directly on the customers. Utilities burning oil will feel the affect of the import fee whether or not their oil happens to be imported or domestic. In 1981, the 350 million barrels of oil burned to produce electricity provided 9% of the total U.S. electricity supply. At the end of the decade in 1990, approximately 440 million barrels of oil are projected to be used to generate about 7.6% of the nation's electricity.

Oil import fees are not in the interest of electric consumers for the following reasons:

*Inequitable: Some utilities and some regions are much more dependent upon oil than others. For example, in New York and New England, oil generated 54% of the region's electricity in 1980. Oil is also widely used in California as well as in Florida, the mid-Atlantic States, the Gulf Coast, and in the mid-West. Electricity consumers in these localities may shoulder a disproportionate share of the import fee.

Industries in these regions which rely on electricity will find their production costs increasing and making their goods and services more expensive. Nationally, in 1980 fuel costs were approximately 38% of the total cost of producing electricity. However in California, the cost of fuel comprised 77% of the cost of producing electricity, and oil represented nearly 42% of the fuel used in 1980. In that same year fuel represented 55% of the cost of electricity in Florida; in Louisiana 60%; in Connecticut 73%; and in Maine 76%. Where other fuels are used to generate electricity, the figures are much different, as in Ohio fuel was 31%; in Illinois 39%; in Minnesota 29%; in Georgia 37%; and in Montana 31%. These state by state disparities indicate the inequity of an oil import fee which adds substantially to the price of fuel.

*Most oil will be affected: An oil import fee is a price support mechanism interfering with the free market. It is likely to result in a price increase for U.S. produced oil and products as well as imported oil and products since domestic producers and refiners would raise the economic rent for their product when handed the opportunity on the basis of government policy.

- 2 -

***Natural Gas Prices will be increased:** Some natural gas purchase contracts have escalator clauses tying the price of natural gas to oil. An import fee could raise those prices also to the consumer of natural gas if that particular escalator clause is in a contract. Additionally, in New Jersey and California, the price of natural gas used as a boiler fuel by utilities is tied to the price of oil by the public utility commissions. The import fee would add to the cost of generating electricity at a time when the public is resisting significant utility rate increases.

***Interferes with economic recovery:** Some states where utilities burn oil, such as Michigan, have weak economies. An oil import fee only adds to the cost of doing business in that state and other similarly affected states, thereby slowing economic recovery.

***May cost utility customers about \$1.5-\$2 billion annually:** Between the import fee and the additional price charged for domestically produced oil, the additional cost could approximate \$1.5-\$2 billion to electric consumers alone. The import fee affects all consumers of electricity produced from oil, whether those customers can afford to bear the burden of this regressive means of raising revenue or not. Utility use of oil is not expected to change dramatically during this decade, resulting in a substantial cost throughout the time an import fee is in effect, since approximately 350-450 million barrels of oil are forecasted for annual use. While the percentage of oil as a means of generating electricity should decrease somewhat throughout the decade, actual oil consumption is projected to remain about the same.

***Coal conversion:** Oil burning utilities are converting to coal as rapidly as they can finance the conversion and receive the necessary environmental permits. Two utilities, the New England Electric System and Virginia Electric and Power Company, have converted 3,520 megawatts from oil to coal and are converting additional capacity to coal. In this decade, Florida Power and Light will displace 240 million barrels of oil by purchasing electricity produced with coal from The Southern Company.

An oil import fee is not going to mitigate the concern over air quality which forces California utilities to import and burn a very low-sulphur crude-oil not generally available domestically.

SUMMARY

An oil import fee is a tax, in the name of a fee. An oil import fee acts against the free market, and distorts true energy investment costs. This regressive tax will strike at the pocketbook of every American, directly or indirectly, and needs to be publically debated as a tax, and not as a fee.

It is obvious that the impetus for an oil import fee is to increase federal government revenues, rather than to discourage oil imports. Federal budget balancing and revenue raising should be based upon equitable criteria, and an oil import fee does not meet those criteria. As a means of raising revenue an import fee strikes only limited classes of consumers when additional funds for the federal government should come from all segments of society. For all of these reasons, the Edison Electric Institute opposes an oil import fee.

BEST DOCUMENT AVAILABLE

Mr. SYNAR. I would like to thank the panel. Those were very informative remarks.

The Chair recognizes Mr. Hiler for questions.

Mr. HILER. Thank you, Mr. Chairman.

Dr. Cooper, I take it you are against tax increases.

Dr. COOPER. Certain kinds—regressive tax increases.

Mr. HILER. You are in favor of tax increases, but only some kind?

Dr. COOPER. No. I am against the imposition of taxes on vital necessities. I am against regressive tax increases that reduce purchasing power for the vast majority of the households in the country, yes. So I am against regressive tax increases.

Mr. HILER. You are against regressive tax increases that would take away purchasing power for most households. How do you define "most households"?

Dr. COOPER. Eighty percent is a number that breaks out in our analysis as a fairly sound number. Those categories are a function of the availability of information in identifying categories.

Mr. HILER. But you are definitely against the \$5 import fee, I gather?

Dr. COOPER. Absolutely against the \$5 import fee.

Mr. HILER. Mr. Montgomery, the one thing that unsettles me about saying that there may be an optimal level of import fee or tariff that would be a positive policy is that mortals have to set that optimal level, and I just have a great reluctance to let mortals try to set that level, rather than at the marketplace set a level for the price of fuel. How are you going to know that you hit the right price?

Mr. MONTGOMERY. Well, we probably never are. It is a matter which all three of us have spent some time discussing with each other and worrying over, as well as looking at, the things other people have done. I don't think there is any way to assert that there is an airtight scientific method to come up with a single number.

The numbers we have seen have run from \$2 to \$124. Now, throwing out the high end of that range as being based on some rather questionable assumptions and ways of counting things up, it still leaves quite a substantial range of estimates that people have come up with, and one could probably widen the range with some additional concerns about how the world oil market works.

Our feeling is that there are enough different reasons for believing that the level of U.S. oil imports is too high, that it is appropriate to take some steps, and that a \$5 tariff is probably not the optimal tariff, but it is at the low end of the range of estimates of how much it is worth to reduce oil imports.

Mr. HILER. How do you respond to the figures that Mr. Sweeney gave about the average price of his barrel, the drop in the most expensive barrel of oil that they bought last year—\$36.51—down to \$27 something right now? Aren't you kind of giving the consumers a kick when you say "you have done a good job, you have conserved, and as a result, we are going to raise the prices back up for you." Because if a little bit is good, a whole bunch has to be a lot better?

Mr. MONTGOMERY. Our view of the import fee is not that it is something that should be put on now in order to avoid a temporary

decline in the price of oil. I think the fact that the world oil price is declining is just extremely good news. It would be perverse, as one of our colleagues pointed out, not to wish that price to go down.

But one of our arguments is that we believe that the import tariff would continue to put that downward pressure on the world oil price. Our idea would not be to reverse this temporary decline but rather to use the tariff as a long-run additional incentive, not one that simply comes on now. I am disturbed about the argument that a tariff would tell consumers that if you conserve, you have to pay more. But I think that the other side is that there is an opportunity to move the tariff in at a time when prices are declining. That does not make the tariff fair, but it does help the size of the shock to the rest of the economy.

Mr. HILER. It concerns me that we decide that Government will impose just another tax down the line to try to keep the revenues up, rather than looking at the spending. The whole thing is oriented toward the deficit. It is not oriented toward energy policy or anything else.

I guess I have real concerns when we promote something for decreasing deficits or raising revenues, and then try to justify it after we decide we want to do it.

Mr. MONTGOMERY. That may well be true. But a study that was administered by Resources for the Future for the Ford Foundation—"Energy—The Next Twenty Years," published in 1979, also recommended an import tariff and a notion of import premium that we are talking about now. So at least in some part of the energy policy and analysis community, the idea has been around for quite some time.

Mr. HILER. Who is that that was in favor of that?

Mr. MONTGOMERY. Hans Landsburg, one of our colleagues, was chairman of the group that put together the book called "Energy—The Next Twenty Years," which was a report of a very large group of economists and others supported by the Ford Foundation.

Mr. HILER. Well, how do you respond then—I have a whole packet full of studies that have been done saying it is going to have nothing but negative impact on the economy for the next 3 years.

Mr. MONTGOMERY. May I ask one of my colleagues to respond to that?

Mr. BOHL. I think the studies are wrong—unless you are willing to accept certain conclusions about the effect of the tariff. For example, if you don't believe that the tariff will have any effect on the world price today and if you believe that the tariff will not reduce our vulnerability to a future oil supply disruption, then you are right that a tariff has only negative effects.

If, on the other hand, you believe that a tariff will lower the world oil price, then GNP shouldn't fall today, it should rise because of a lower import bill. Lower imports also lowers the deduction in GNP that is available for domestic consumption. This produces an expansionary effect on the economy beyond the reduction in the wealth transfer abroad. So if you believe that the world price will fall, and therefore, our import bill will fall, GNP won't fall, it will rise. GNP will also rise in the future as a result of lowering the vulnerability to disruptions.

Mr. HILER. I guess we get back then, to how do you set that level? If a little bit is good, a heck of a lot of tax must be a lot better. If you lower the price by raising taxes, let's raise taxes on everything.

Mr. BOHI. That sounds right but it is not. You can go too far. As Mr. Montgomery has pointed out, you want to be conservative about how much of a tariff you want to put on, because it is easy to go too far. We think \$5 is conservative.

Mr. HILER. I yield back, Mr. Chairman.

Mr. MOFFETT. The gentleman from New Hampshire, Mr. Gregg.

Mr. GREGG. I would like to follow up on that line of questioning. Obviously there is a disagreement. You don't agree with Representative Conte's position then, that some enterprising young oil person in the United States may raise their prices by \$5 and pick up the extra profit. You think everybody is going to lower their prices as a result?

Mr. BOHI. No, I think that they will raise their price. They will raise the price to the world price. I don't think that the domestic price will rise the full \$5, rather a fraction of it.

Mr. GREGG. \$3.75? That figure was thrown out by Dr. Cooper.

Mr. BOHI. Something like that would be more reasonable, yes.

Mr. GREGG. So oil prices will rise?

Mr. BOHI. Oh, yes.

Mr. GREGG. And they will rise on the imported barrel. But you would agree with Mr. Conte's position that they will also rise on the domestic barrel?

Mr. BOHI. Exactly.

Mr. GREGG. So it is basically a windfall profit to the domestic companies?

Mr. BOHI. That is right.

Mr. GREGG. And there aren't any domestic companies in New England, where we happen to consume 80 percent of the oil we are paying for?

Mr. BOHI. That is right.

Mr. GREGG. Sort of a regional tax, isn't it?

Mr. BOHI. I suppose you could argue that an oil tax does hit the Northeast disproportionately.

Mr. GREGG. The South and West are going to make \$3.75 on a barrel, windfall profits, and the Northeast is going to pay extra in taxes. It is a regional tax.

Mr. BOHI. We also have had statements it is going to hit every household, which suggests it is going to be somewhat shared by all.

Mr. GREGG. It is not going to hit the household with the oil well in the backyard.

Mr. BOHI. No question they will be better off.

Mr. GREGG. Thank you.

Mr. MOFFETT. The gentleman from Ohio, Mr. Oxley.

Mr. OXLEY. Thank you, Mr. Chairman.

I just have a question for Mr. Sweeney. Has there been any effect on the prices you charge your consumers based on the savings that you had with the reduction in the oil prices?

Mr. SWEENEY. Within the State regulatory process, within the statutes under which we operated, the fuel charge per se is a pass-through. The revenues come in, it is a passthrough. When we buy

the oil it is a passthrough to the consumers, a separate item on his bill. He has a base rate on his bill and a fuel adjustment charge calculated on the kilowatt hours generated or period of time against the oil used at that period of time, the price of the oil used, and that is a passthrough. It is not a revenue stream for the company.

So if you go from \$36 to \$27.75, or conversely, you go \$27 to \$36, the customer is going to see that 25-percent decrease or increase directly. It is a one for one passthrough. Whatever increase we see, the customer immediately sees.

Since 1973, I have watched with a great deal of dismay, \$27 go up to \$36, and you just watch the impact and you see customers getting an electric bill now for x dollars, and 50 percent of that bill has nothing to do with anything other than the fact that the oil is there. The other half of the bill is in fact the base charges for the operating and maintenance expense of the corporation, but 50 percent of that customer's bill is in fuel.

Now, anytime we can get our hands on something that can drop that down, and it is in fact a straight passthrough, then I want it, and I don't want anything on there to add on to the customer's bill.

Mr. OXLEY. Has that indeed been what happened?

Mr. SWEENEY. Yes, sir. It has to happen. It is the statute. It is not something I choose to do, it must happen.

Mr. OXLEY. It has happened in the last several months?

Mr. SWEENEY. Absolutely, sir. Month to month it happens.

Mr. OXLEY. I had the opportunity to live in New England for a while. One of the things that I felt was rather disturbing to me, as somebody from the Midwest—and I am sure people from the Southwest would tend to agree with this—is that we found a continuing concern about the effects of trying to find energy in New England, many people opposed to any efforts at all at offshore drilling and that type of thing. Yet, we found the same people who were adamantly opposed to that type of effort, the same people who were incensed about the high cost of energy to heat the homes of New England.

Do you find a basic dichotomy there, and in fact is that concern that is expressed in the Southwest and Midwest justified?

Mr. SWEENEY. I think there is a basic dichotomy in segments of New England that quite frankly defy description. You know, I spend a lot of time up in Maine, in Mr. Gregg's area, and Massachusetts. It is a different area. They just don't want you playing outside the waters. They prefer you don't dig up the ground to put in transmission lines. They prefer everything to remain pristine. We all like to have environmentally sound areas and pristine areas to live in, but the realities of the world are if there is stuff out there and it can help us, and we can keep the environmental constraints under control, then yes, we ought to go and get it. It belongs to this country, let's use it.

Within the environmental constraints we ought to build the transmission and things we need to bring the lower cost power into the area. There is power out there. We can bring it in. We can generate it further away and bring it in. We can do those things within environmental constraints. We can do them by engineering properly.

I just don't think we have been able to get a message to all the segments of the people as to how serious the situation might be in 1985, 1990, when perhaps something does happen to the economy and growth does return, and then my industry is called on to fuel that economy growth and it is not going to be there. And that is the sad part of it, and somehow we have not made that message clear.

Mr. OXLEY. I appreciate your comments. I yield back the rest of my time.

Mr. MOFFETT. The Chair would note with regard to our region, that New England has done an excellent job in terms of conservation, leading the Nation in cutting its use of energy, utilizing renewables. It has provided a real model in that regard, and that model will be more important 20 or 30 years from now in terms of energy produced than the model of James Watt leasing a billion acres offshore. I think we will look back on this period of concentration on conventional energy development as somewhat narrow. But we will see.

Mr. Montgomery, the Office of Competition at the Department of Energy performed a study of the import fee, as you may know. That study suggests taxes on a commodity should only be attempted if the Government believes it is best able to determine the proper level of consumption or if there are real costs for the product which are not included in its price.

You are probably familiar with that study.

Mr. MONTGOMERY. I am not familiar with the specific study, but certainly with the argument.

Mr. MOFFETT. Without objection, the Chair would insert that study into the record, along with two recent studies from the Library of Congress.

[The information follows:]

AN EXEGESIS ON NEW OIL TAXES*

I. INTRODUCTION

Lately, there has been a substantial amount of editorial space devoted to calling for some type of tax or duty on petroleum products (particularly gasoline) or imported crude. We will focus primarily upon a discussion of an import duty on crude oil, but we will also discuss several variations such as a gasoline excise tax or a tax on all petroleum products.

There are three primary rationales for imposing an import fee or other petroleum excise tax:

- o Conservation efforts, alternative energy development, domestic production, and more efficient energy usage by both business and consumers will be maintained and accelerated with higher oil prices causing beneficial effects upon the long-term economic prospects of the United States.
- o The import effects of higher oil prices can mean lessened dependence upon imports, reducing our exposure to future disruptions or threats of disruption, increased domestic oil production, and further destabilization of OPEC. Also, an import fee could be a "user fee" dedicated to financing strategic programs such as the Strategic Petroleum Reserve (SPR) made necessary by our dependence upon imported oil.
- o Government revenues can be increased directly through the tax, indirectly through more taxes generated from the crude oil windfall profits tax, and from increased receipts from royalties from federal properties and other properties such as the Naval Petroleum Reserve.

* Prepared by H. Robert Field, Policy Analyst, Office of Competition, Department of Energy.

II. DISCUSSION OF THE RATIONALES FOR IMPOSING AN IMPORT FEE

A. Inducement to Conservation, Increased Domestic Production or Alternative Energy Development

The argument that an import or other excise fee is needed in order to assure the continued development of domestic production, conservation, and alternative energy sources depends upon the assumption that the current glut-induced price squeeze will cause a reduction in spending in these areas which is not consistent with long-term economic efficiency. It is important to emphasize this last limitation because it is just as possible to spend too much in these areas as to spend too little. Resources which are spent for the reduction of energy consumption or increased domestic production are not available for modernizing factories, research and development, or competing with the Japanese in computers or other fields.

Absent external costs which are not borne by the market (such as the cost of the strategic petroleum reserve discussed below) a properly functioning market will maximize the efficiency of capital and other inputs between energy uses and various other uses to which they can be put. Government intervention in the form of an excise tax cannot improve upon this efficiency unless the government is in a better position to predict the future course of oil prices than is the private market.¹

In arguing that the current oil price drop will cause "too little" to be spent on energy production and conservation, and too much to be spent

¹ This is true whether the prices are determined in a competitive market or by a foreign cartel. In either case we would expect a gradually increasing real price over time when dealing with a wasting asset like oil with few close substitutes for some uses. The point is it is the ability of the market (or government) to predict the course of these prices over time that affects the efficiency of investments which pay out over a long period of time.

on other uses of these resources, we are in effect arguing that our estimate of the oil price trends over the next three to ten years is superior to that of the market, that is, the collective judgments of all those making investment and consumption decisions.

So far, none of the proposals put forth have disclosed any rationale concerning why the government's view of the future course of oil prices is likely to be more accurate than the view of those who have the responsibility for actually spending and investing the money.

It is true that the market has twice been caught by unexpected price hikes. It is equally true, however, that the government was also surprised by these events. Furthermore, having been twice caught by such unexpected hikes the market has developed a good deal of sophistication and is unlikely to abandon its long-term conservation efforts at the first sign of lower prices.

This is not to say that the current price moderation will not have an impact upon various corporate investment decisions. Most people, including the government, have modified their views on the future course of oil prices. But the key issue is whether the newly modified government view can be shown to be superior to that of the private market. If not, there is no good reason for using the tax structure to try to modify private investment decisions.

It is also important to note that the postponment or elimination of some domestic production, conservation, or alternative energy investment decisions will have some good side effects. Petroleum production, development of alternative energy sources (particularly synthetic fuels) and many conservation investments tend to be very capital intensive. The postponment

or elimination of these investments will release substantial monetary resources, which may ease the pressure on capital markets and lower interest rates, while encouraging productivity and research and development investments, which in turn may increase productivity and reduce inflationary pressures.

There is, therefore, no reason to believe that the resources which may be freed by this new view of the probable future course of world oil prices will not be more efficiently used than originally planned.

B. Import Effects

1. Decrease Import Dependence and Reduce Exposure to Future Disruptions

Any reduction in the amount of oil imported by the United States will decrease dependence on imports and reduce some of the exposure and associated costs of a major disruption. However, the size of the world oil price increase that accompanies such a disruption, which is one of the major causes of the dislocations resulting from a disruption, would not necessarily be affected by a reduction in U. S. imports. The U. S. economy would suffer a serious shock in the event of a major shortfall in world oil production even if it imported no oil because of the close links between the U. S. economy and the economies of our trading partners. The impact of a sudden increase in world oil prices would ripple through our economy as well as the economies of our trading partners.

Furthermore, since our allies would remain vulnerable to blackmail from the threat of a politically motivated embargo, we could not insulate ourselves from such threats even by total elimination of imports.

Additionally, crude shortfalls tend to be shared proportionally by the consuming nations (even without an international sharing agreement), so that the impact of the original disruption is spread among consuming countries and this fact tends to undermine the possibility of "targeted" disruptions.

Given that a tariff may have some benefits during a disruption,² it is still true that there are much more cost effective ways of achieving such benefits. Two other alternatives, the strategic petroleum reserve and the encouragement of diversity of supply are examples. Furthermore, these alternatives have the additional benefit of discouraging or eliminating politically motivated deliberate supply interruptions.

One of the impacts of an import tax which reduces our exposure to future disruptions is increased domestic production, which may be a two-edged sword. The economically premature development of higher cost domestic oil reserves has both advantages and disadvantages depending on the time frame examined. Since oil is a depletable resource, the long-term real price of oil must go up as reserves are exhausted. Oil reserves which are exploited now are not available when the world price of oil inevitably climbs in real terms.

Previous attempts to limit our strategic vulnerability through oil import quotas, resulted primarily in the premature depletion of our domestic reserves which might have been more usefully employed in limiting the impacts of the 1973 and 1979 price explosions.

² The benefits accrue primarily because of the lower levels of imports produced by the higher price of oil during nondisrupted periods. Because of these lower import levels, less money would be sent out of the country during a disruption.

An import tariff which is imposed for other reasons (for example, as a revenue raising measure) will have the additional benefit of limiting some of the costs of a disruption, but reduction of exposure to disruptions is not in and of itself a good reason for imposing such a tariff.

2. Import Tax as a Means of Bringing Pressure on OPEC

The current oil glut has caused significant internal frictions within OPEC. OPEC has gone to the extent of officially considering country production quotas although the most important member, Saudi Arabia, claims to be aloof from any such agreement. Monitoring and enforcement of such quotas, particularly with regard to sovereign nations, often has been thought of as the achilles heel of international cartels. Some believe that an import tariff reducing United States demand might add sufficiently to the world oil glut to bring about the demise of OPEC.

A reduction in world oil demand would be caused by a \$2-4 U. S. tariff.³ It is not at all clear that this marginal reduction in demand would have much of a draconian effect on OPEC. Furthermore, an uncontrolled collapse of oil prices would not be without significant economic and political costs. The collapse would be temporary because of the physical limit on the amount of low cost crude oil available. Finally, such a collapse would not necessarily be the end of the cartel. Experience with domestic price fixing rings indicates that the rings often reemerge stronger than before from bouts of unrestrained price cutting.⁴

³ One study has estimated that a \$4 U. S. tariff would decrease U. S. imports and thereby world demand by approximately 200,000 bbls/day in 1983. See Business Week, April 5, 1982, p. 28.

⁴ See letter from John Kuhlman in Challenge, March-April, 1982, p. 63.

It is unlikely, therefore, that the import duty, by itself, will result in bringing OPEC down. This goal is much more likely to be the result of world conservation and substitute fuel development and the increasing development of new oil sources in non-OPEC countries.

3. The Import Fee as a "User" Fee to Finance the SPR and other Strategic Alternatives

The cost of the Strategic Petroleum Reserve is now being paid out of general tax revenues by the taxpayer. It would not be unreasonable to expect those who import oil, and who, therefore, will benefit the most from an assurance of supply during a disruption, to bear a substantial portion of the cost burden of such assurances. Furthermore, it could be argued that the cost of providing a SPR and other strategic options is one of the "externalities" (i. e., the external costs) of using oil and that unless the users of oil are forced to pay this cost rather than be "subsidized" by the general public, more oil will be used than is economically efficient.

This argument makes some economic sense if the fee is limited to the amount necessary to take cost-effective strategic measures to limit our exposure to disruptions. It would make even more sense if the fee were distributed over all oil users since the SPR would be cost-effective even if we imported no oil as we discussed above.

By forcing oil users alone to bear the burden of financing the Reserve developers of alternative energy sources such as coal would be encouraged, but only to the extent that the cost of the Reserve represented part of the "real" cost of using oil. The 1983 budgeted cost of the SPR program is \$2.3 billion.

C. Increasing Government Revenues

An import fee would generate increased revenue for the government in three ways. First, the collections of the revenue fee itself. Second, the import fee, by increasing the price of imported oil, also will increase the price of domestically produced oil and a significant proportion of any increase in domestic oil prices is recaptured by the crude oil windfall profits tax and to some extent by the corporate profits tax. Third, higher oil prices mean higher revenues for a number of federal programs such as the sale of royalty oil from offshore leases, income from lease sales and sale of oil produced on government reservations.

Net government revenues are significantly reduced by the indirect effects of the fee, however. The fee would increase the rate of inflation; therefore, government payments tied to the inflation rate, such as social security and government pensions, would increase. Because of the erosion in consumer spending power and therefore demand in nonoil areas and because of increasing input costs, the profits of nonoil companies would be reduced thereby reducing federal tax revenues.

The net result on federal revenue from these offsetting factors would be positive but much smaller than the larger numbers so widely claimed.⁵ The gross revenue produced by various import fees as estimated in several studies with different assumptions and using different modeling techniques are:

⁵ For example, the Congressional Budget Office (CBO) study estimates that the increased cost of Social Security and other entitlement programs alone will add \$1-2 billion to government outlays.

	Gross Revenue (billion dollars per year)			
	<u>\$5.00/Bbl</u>	<u>\$4.00/Bbl</u>	<u>\$3.00/Bbl</u>	<u>\$2.00/Bbl</u>
CBO Study	9.9			4.0
Business Week		8.4	6.2	

There are two basic arguments for raising revenues primarily through an energy tax (assuming first that the increased revenue is needed). First is the argument that such a tax will accomplish all of the goals described above (i. e., conservation, increased production, etc.). Second is the argument that because crude oil prices are declining it will be politically easier to impose it because taxpayers will not notice it as much. In addition, some argue that a tax raising the price of gasoline will bring our tax system into closer conformance with the tax systems our principal trading partners which is seen as an advantage. Finally, because of the slack demand some of the incidence of the tax in fact may be borne by the producing countries rather than United States consumers.

There is one other aspect of using this tax as a means of raising revenue that some see as a benefit. The burden of this tax falls primarily on consumption (of gasoline, heating oil, etc.). Other substitute sources of increased revenue such as a postponement of the scheduled reduction in income tax rates would burden both income used for investment as well as income which is spent. If you believe that individuals in the United States are saving too little and therefore consuming too much there is an argument for shifting the incidence of taxation from all income to just that income used for consumption.

There are several arguments against using this tax purely for revenue raising purposes. First, any type of special tax such as this one will reduce the overall efficiency of the economic system unless it is merely intended to offset what would otherwise be a market failure (i. e., to internalize an external cost such as the cost of the Strategic Petroleum Reserve). The government is essentially intervening in the market and telling consumers via the tax mechanism that they shall consume less of a certain product (in this case oil) than they would otherwise prefer to consume. This will be efficient only if the government knows better than consumers what will please them or if there are real costs for the product which are not included in the price of the product.

The second major argument against raising revenue through this particular mechanism is that a tax on crude oil tends to be regressive in that it affects the income of low income consumers to a greater degree than that of better off consumers. The portion of a consumer's budget which goes to energy tends to be much higher for low income consumers than for higher income consumers. Therefore, the burden of this tax will fall disproportionately on the poorer consumers. And, of course, any consumption tax will fall more heavily on poorer and younger consumers who tend to spend larger portions of their salary than their older and better off counterparts.

Politically, the advantages of an excise tax on a product that is going down in price is somewhat offset by the fact that the tax is both regressive and unequal in its impact on a regional basis. A tax which raises the price of all crude oil products is perceived as causing a special burden in the Northeast and particularly New England because of

the prevalence of heating oil use. This is somewhat offset by the heavier gasoline use in the Western states; but the perception of unfair burden is still there.

A final disadvantage which is both real and political is that the tax will tend to transfer assets and profits from the rest of the economy to the oil industry. In 1980, the oil companies reported 40 percent of all manufacturing profits or 30 percent of all corporate profits. The decrease in oil prices will tend to readjust these figures to a more reasonable balance.

The political problem of transferring money from consumers to some of the richest corporations in the country is obvious. Not so obvious are some of the real inefficiencies that may result. Where decisionmaking and particular capital investment decisions are concentrated in too few hands some of the inefficiencies of centrally planned economies may be introduced. Because managers of assets in one industry may be unfamiliar with opportunities in all other industries or may not have the experience to take advantage even of those of which they are aware, there may be too much investment in a narrow band of industries with which the managers are closely familiar.

D. Oil Import Fee vs. General Tax on Oil Consumption

An oil import fee will raise both domestic and imported oil prices. Part of the resulting increase in the domestic oil prices will be reclaimed by the government through the windfall and corporate profits tax while the remainder will serve to maintain the incentives for oil and gas exploration at their current levels. The advantage of such a fee is that it would preserve domestic exploration incentives while discouraging oil imports.

A general tax on consumption would preserve conservation and alternative fuel development, but would act as a disincentive to additional domestic production.

There is some disagreement as to whether an import fee could be unilaterally imposed by the President now that EPAA has lapsed but there is at least the possibility that it could be put into place without legislation. A general tax would require legislation.

The imposition of an import fee has the political disadvantage in that it could be seen as a move to benefit the oil industry at the expense of the consumers which is not a politically popular move in the best of times. An overall tax on all petroleum products to finance the SPR probably would be lower and probably would be seen as fairer although it would have the effect of lowering domestic production incentives.

E. Complexities Introduced by an Import Fee--Marketplace Distortions

Inevitably, an import fee on such a basic commodity as crude oil will create enormous pressures from the affected interests for special exemptions and exceptions. If past history is any guide, many of these efforts will be successful. Some examples might be instructive.

An import fee on crude oil without a comparable fee on refined products would merely drive much of the domestic refining capacity overseas where there is ample spare capacity. If the fee were extended to products there would be substantial pressure to make special exceptions for those refineries, particularly in the Caribbean basin, which were built to serve American markets. Furthermore, there probably would have to be an exception in the form of an export rebate for those industries such as petrochemicals

whose international competitiveness is dependent upon obtaining crude at no more than the world price. Finally, companies with access to "low cost" domestic crude would be accused of predatory intentions by others, particularly independent refiners, which would demand access to the "wind-fall" created by the import duty.

The list could be extended practically without limit and once a class of exceptions was made a bureaucracy would have to be created to administer the exceptions. It is a road down which we have traveled several times, mostly with disastrous results.

F. Macroeconomic Effects

The following results are taken from an article in the March, 1982, issue of Business Week:

How an oil import fee would hit the U. S.

	Effect on U. S. economy if a fee were imposed on January 1, 1983	
	At \$4 per bbl.	At \$3 per bbl.
Gasoline, heating oil price	Up 8 cents per gal.	Up 6 cents per gal.
Crude oil imports	Down by 200,000 bbl. per day in 1983, as much as 260,000 per day in 1986-87	Down by 150,000 bbl. per day in 1983, as much as 200,000 per day in 1986-87
Oil production	Up slightly after 3 to 4 years	Up slightly after 3 to 4 years
Reduction of federal deficit, 1983-85	\$8.5 billion annually	\$6.2 billion annually
Inflation rate, 1983	Add 1 point	Add 0.8 point
Gross national product	Real growth cut 1 point in 1983, recovering in 1984	Real growth cut 0.7 point in 1983, recovering in 1984

III. CONCLUSION

The arguments for and against the imposition of an import fee are summarized below:

o It will encourage conservation and substitution.

FOR

- It will lower total consumption of energy.
- It will increase energy efficiency (i. e., reduce the quantity of energy consumed per unit of output).
- It will encourage the development and use of petroleum substitutes and alternative energy sources.
- It will prevent a return to earlier "wasteful" habits of energy use.
- It will prevent the premature cancellation of economically sound conservation and alternative energy projects if the oil "glut" is temporary.

AGAINST

- It will substitute the judgment of the government for that of the marketplace in distinguishing between permanent and temporary shifts in price.
- It will create incentives to spend too much money on capital-intensive conservation and alternative energy projects which more profitably would be spent on industrial modernization.

o It will reduce our dependence on unstable sources of imported oil and bring pressure on the OPEC cartel.

FOR

- It will lower the amount of oil imported reducing import dependence.

- It will bring additional pressure on OPEC further destabilizing it and perhaps leading to its demise.
- It will lower costs of future disruptions.
- It will encourage development of domestic reserves.

AGAINST

- There are much less expensive ways to reduce exposure to disruptions (e. g., SPR and diversity of production).
- A reduction in imports is likely to have only a very small adverse impact on OPEC.
- Impossible to eliminate vulnerability because of cost and interdependence of our economy with others who have virtually no domestic production.

o It will generate badly needed new revenue

FOR

- It will generate revenue both directly through the tax itself and indirectly through the windfall profits tax and receipts from other federal sources.
- It will fall primarily upon consumption rather than savings which will tend to encourage savings and investment.
- It will act as a "user fee" rather than a tax increase, if the incidence of the tax is limited to paying for the cost of the SPR and any other government expenses made necessary by strategic dependence upon imported oil.

AGAINST

- Direct and indirect revenue effects must be set off against higher payments on indexed government programs due to inflation.

- Increased revenue also must be set off against lowered federal tax receipts from nonoil corporations because of lower profits.
- As a special tax on a single product it tends to be economically inefficient unless there is a market failure.
- It has serious macroeconomic effects, particularly in the area of increased inflation.
- It probably has a greater impact on the poor than on others and on some regions (New England) than others while significantly benefiting the major integrated oil companies (i. e., a regressive tax).
- It will lead to significant and probably successful pressures for new sets of regulations to protect special groups from its direct and indirect impacts (e. g., exporters, Caribbean refiners, nonintegrated refiners, etc.).
- It will tend to concentrate an unhealthy proportion of all corporate investment decisions in relatively few hands.



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BACKGROUND ON OIL IMPORT FEE PROPOSALS:
SOME POLICY AND ECONOMIC CONSIDERATIONS

by
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April 7, 1982

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BACKGROUND ON OIL IMPORT FEE PROPOSALS:
SOME POLICY AND ECONOMIC CONSIDERATIONS

by
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Environment and Natural Resources Policy Division

The economics of import fee proposals depend on a number of variables. Of initial importance is that the fee be levied on foreign refined product, as well as crude oil. This ensures that domestic refining was not discriminated against, and closes a potential loophole wherein the fee could be avoided by importing products exclusively. Virtually all recent proposals of this sort provide for equivalent treatment of crude and product imports, and we assume that the proposal under consideration will do this too. The factors which will then determine the general size and shape of the fee's effects are the level of imports, amount of domestic oil supply, and the extent to which the domestic and world oil markets can pass on the higher prices. The latter item has become something of an issue, at least for the near term, since there appears to be a surfeit of petroleum on both domestic and international markets. The extent to which these markets can accommodate the fee and pass it on in terms of higher prices is discussed in this paper, as well as the general impacts of a fee proposal and some of the policy issues involved.

1. Import Levels

Today's import levels of about 4.2 million barrels per day (mbd)—1.6 mbd of refined product and 2.6 mbd of crude—reflect seasonality as well as the fact that domestic inventories are being drawn down at about 0.3 mbd. On the basis of market conditions and inventory economics, the withdrawals can continue for at least 6 months at this rate, and may well continue through the remainder of

CRS-2

1982. With overall domestic demand for oil products expected to average an estimated 16.1 mbd in both 1982 and 1983, Table 1 shows the implied demand for imported oil, given domestic supply under current conditions (i.e. with no fee).

At these import levels, a fee would generate gross Treasury revenues of about \$1.9 billion per year per \$1.00/bbl of levy in calendar 1982 (at an annual rate) and \$2.0 billion in calendar 1983, assuming no "conservation effect."

TABLE I. Estimated U.S. Oil Demand, Supply and Imports—1982 and 1983 (mbd)

Year	1982	1983
Total Product Demand	16.1	16.1
Supply:		
Domestic crude output	8.6	8.6
Domestic natural gas	1.6	1.6
Liquid output		
net processing gain in refining	0.5	0.5
inventory adjustment	0.3	no stock change
Sub total	11.0	10.7
Implied Import demand	5.1	5.4

Source: CRS estimates based on Weekly Petroleum Status Report Data.

2. How the Fee Will Affect the Price of Domestic Oil

Conventional wisdom holds that domestic liquid hydrocarbon supply tracks the price of imported crude fairly closely. If this is the case—and while it has been in the past, it may not currently be true—crude oil and the other components of domestic supply would rise in parallel with the fee increment on imports. This thinking would lead to the belief that the price of 8.6 mbd of domestic crude output would rise by \$3.1 billion annually per \$1.00 of fee.

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CLS-3

Natural gas liquids (NGL) are the next most important supply component, providing 1.6 mbd of natural gasoline, propane and butane. NGL's are nearly equally divided between natural gasoline and liquified petroleum gas, the latter selling at a discount reflecting its Btu content (70% that of oil) and the former selling at oil equivalency because of its value as a motor fuel component. NGL's prices should escalate on average by about 83 percent of the crude fee related increment. This works out to about \$0.5 billion per \$1.00/bbl of fee on an annual basis. It should be noted that NGL's are not subject to the windfall profits tax (WPT).

Another important supply component which often goes unnoticed is the processing gain realized in refining. Every year there is a net volumetric increase in oil product supply because of net gains realized during the refining process. Presumably this portion of supply tracks the imported crude price. It would escalate by somewhat less than \$0.2 billion for each \$1 of fee. This would accrue to refiners and is also not subject to WPT.

3. Demand Reduction

This discussion represents an attempt to crudely characterize the bounds of price induced conservation which might be realized with the fee proposals. Consensus estimates of near term demand elasticity for crude with respect to prices are on the order of -0.1 to -0.2, meaning that a 10 percent price increase, for example, would result in a 1 percent to 2 percent demand reduction. In the longer term, it is likely that this demand reduction would be significantly larger, a matter which is avoided here since we focus on the near term. Table 2 shows currently anticipated 1982 and 1983 demand estimates and how various fee proposals would affect demand and reduce inputs. An underlying assumption here is that the fee would be passed on to ultimate consumers in its entirety, offset of course by the demand reduction's value.

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CRS-4

This pass-through assumption is made in part for analytic simplicity and partly because a case can be made that market conditions will sustain it. This is to say that the decline in domestic oil stocks and the consolidation of OPEC output in the 18-19 mbd range would tighten the market enough for the fee to be completely passed on to final consumers. Alternative pass-through assumptions are explored in the companion paper, Revenue and Macroeconomic Impacts of an Oil Oil Import Tax by B. A. Galb and E. W. Hull.

TABLE 2. Import Savings Under Various Fee Alternatives (MBD)

Fee	New Demand	Import Savings— Reduction from Present Estimates
\$2	16.0-15.9	0.1-0.2
\$3	15.9-15.6	0.2-0.3
\$10	15.6-15.1	0.3-1.0

While both recent history and underlying economic theory point toward the inevitability of price induced conservation, this does not guarantee that currently anticipated import levels will be lowered. A good example of what is meant here is in regard to a \$2 fee and currently projected demand. The base case 16.1 mbd demand estimate we have been working with has been forecast based on recent price history. However, the imported price has fallen about \$3./bbl since last spring's high. In fact a \$2 fee might only serve to solidify conservation gains by tending to restore old price levels and not reduce estimated 1982-83 demand measurably. Under such circumstances, those expecting absolute demand and import reductions would likely be disappointed. Nevertheless, the conservation effect would still be real—demand in the future would otherwise be higher because of the effective price decline.

CRS-3

4. Economic Impacts on Fuel Users

Simply stated, Table 3 shows the gross revenues associated with the various fee increments under consideration, assuming that the whole fee is passed on to ultimate consumers in terms of higher fuel prices. It shows how the revenues accrue to various beneficiaries, and how the national petroleum bill increases. With this last item, it should be noted that fuel users pay more money for less fuel. This must be traded off against a number of benefits, one of the most discussed being the import savings. But this benefit comes at a relatively high cost per bbl of imports saved. For example, with a \$2 fee and savings in the 0.1 and 0.2 mbd range, between 36.5 and 73.0 million bbls per year are saved. But this savings comes at a national cost of roughly \$11.5 billion in higher fuel bills, as the price of 245 billion gallons of fuel forecast to be consumed yearly rises by 4 3/4 cents a gallon. It must be emphasized that these gross Treasury revenues do not include interactive effects of the fee on other taxes. This matter is also addressed in the companion CRS paper.

Revenue and Macroeconomic Impacts of an Oil Import Tax.

One of the questions raised is how the Federal Government fares as the major fuel user that it is. In 1980, the 1980 EIA Annual Report to Congress, Vol. 2 (Table 87) reports that the Government used 1 Quad of petroleum products. This translates into about 170 million bbls annually. The fee would effect all of this if it were to be fully reflected in the price of all petroleum sold nationally. Thus, every \$1 per bbl of fee would raise the Federal fuel bill by \$170 million yearly, (excluding reductions in consumption).

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CRS-6

Table 3. Gross Revenues From Various Fee Levels (\$ billion)

Fee Level	Gross Treasury Revenues * 1982 1983	Crude Producer Revenues	NGL Revenues	Refiner Rev. From Process. Gain	Increased National Oil Bill 1982 - 1983
\$ 2	3.6 -3.8: 3.8- 3.9	6.3	1.0	.4	11.3-11.5: 11.5-11.6
\$ 5	8.4 -8.9: 8.9- 9.4	15.7	2.5	.9	27.5-28.0: 28.0-28.5
\$10	16.1-16.8:16.1-17.9	31.4	4.9	1. 8	54.2-54.9: 54.2-56.0

Source: CRS estimates.

*/ Note: The figures include fee collections only and do not reflect changes in other taxes caused by fee imposition.

3. Will the Fee Be Passed on to the End Users?

Would or could U.S. crude producers raise their own prices to match the newly increased price of imported oil which would presumably have risen by the fee increment? This question was motivated by the underlying perception that domestic oil prices had lagged those of imports by a significant amount. There have been expressions of suspicion that this was a recent phenomenon which might be due to integrated oil companies deliberately depressing wellhead crude prices to avoid the windfall profits tax, and making up this revenue reduction in downstream operations. If this were to be true, visible symptoms would be domestic crude priced below imports, and refiners gross margins on products would be higher than they have historically been.

While the linkage between domestic crude and import prices may not be as clearcut as might be expected, Table 4 shows that there has been an apparent change in the uncontrolled domestic-import price relationship during the past several years. Table 4 attempts to show an historic pattern by contrasting the prices of uncontrolled domestic crude with imports. Note that during the period

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CRS-7

1977 through 1980, uncontrolled domestic (represented here by stripper oil which was uncontrolled throughout this time frame) and imported crude tracked reasonably well (although not penny for penny) given the fact that the comparison is for stripper wellhead prices with delivered imports. Yet, in 1981, wellhead prices for virtually all crude (all domestic crude was completely decontrolled in February 1981) were far below the refiner acquisition price of imports. This coincides with the windfall profits tax becoming fully effective. While there is no well defined chain of causality here, this large discrepancy is certainly compatible with the theory that integrated firms might be shifting transfer pricing patterns to minimize the incidence of the WPT. While transport cost from wellhead to refinery and the revenues of brokers and traders could raise the refiner acquisition cost of domestic crudes (which averaged \$3.11 above the wellhead prices in 1981), this large differential itself plus the surprisingly big difference between wellhead and refinery prices remains hard to explain and suggests further study.

Table 4. Domestic Uncontrolled Crude and Import Prices (\$/bbl)

	Domestic Wellhead	Imported Refiner Acquisition	Domestic Minus Imported Difference
1977	13.39	14.33	- .94
1978	13.95	14.57	- .63
1979	22.93	21.67	+1.26
1980	35.48	33.89	+1.59
1981	32.27	37.20	-4.93

SOURCE: March 1982 Monthly Energy Review.

CRS-8

One other possible explanatory factor should be noted which might account for some of this discrepancy. This is the fact that many importers were taking crude under contract from producers at above market prices during 1981. This may account for the seemingly high price of imports when viewed in relation to domestic crudes. U.S. oil companies with special relationships with producing nations could have been in situations wherein prudent business practice would call for taking high priced—perhaps over-priced—oil in order to maintain valuable long run business relationships. If this were the case on a large scale during 1981, it could partially account for the unexpectedly high price of imports relative to domestic crudes. Domestic crudes, at the same time, may have been priced correctly, reflecting market forces uninhibited by OPEC pricing tactics. This is to suggest that actual market forces were more effective in determining domestic prices than foreign crude prices.

In any event, the large gap between domestic and foreign prices is hard to explain based on economic theory alone. Theory would lead us to believe that prices should be closer together. And any increase in the price gap should be unsustainable, even less sustainable than the present situation. It would be expected that a fee enlarged gap would be closed, probably by domestic price rises.

There is also the matter of whether or not the world oil market would absorb the fee by discounting crude to offset it while always a short term possibility; this seems unlikely in the face of recent OPEC behavior. With a substantial surplus on world markets during most—especially the latter part—of 1981, and eroding prices, OPEC and other producers began to cut output. Platt's Oilgram News (4/1/82) reports that OPEC output fell from 21.3 mbd in December to 20.7 in January. This is 4.0 mbd below last year's production.

CRS-9

With further output cuts announced, and the likely decline in OPEC output to the 18.5 mbd area, it would seem that any surfeit of world market crude would be consumed by mid year. Given these circumstances, it appears doubtful that a reduction in the U.S. demand for imports by at most of a few hundred thousand bbls daily would depress the market enough for a fee to cause a reduction in world prices (and thus be absorbed).

The next matter that is repeatedly raised in this area regards refiner margins. Gross refiner margins—the difference between crude cost and the price of refined products—should show an increase relative to the historical trend after WPT became effective. There are a number of estimation problems here, but the contrast between wholesale product and crude prices provides a general indication of the gross revenue attributable to refining. Good data are available for gasoline and distillate, which comprise 60 percent of nationwide consumption. The gasoline data were made available to CRS by special arrangement with the Lundberg Survey. Another major problem is that much of the relevant historical period involves a situation with price controls on crude and none on refined products, except for gasoline. This is likely to have distorted margins, since products could sell at market clearing prices, while crude was controlled to a significant extent.

Looking at the data we have—average heating oil and diesel distillate prices from the Monthly Energy Review—and gasoline prices from Lundberg Survey, and contrasting them with the refinery acquisition cost of crude—we see no major upward shift during the past three years for distillate. Gasoline presents a less clear picture, with margins apparently much higher than distillate. In comparison, distillate margins seem relatively thin. While gasoline prices have fallen in recent months, data are not yet available to estimate

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CRS-10

what might have happened to revenues attributable to refining. But the 1981 data do suggest that refiners could absorb part of a fee (or all of a small levy). So there is a possibility that the fee pass-through might be less than complete, at least in regard to gasoline prices. More current data might help clarify this situation somewhat.

TABLE 3. Gross Refiner Margins—Gasoline and Distillate (c/gal)

	Gasoline	Distillate	Crude	Gasoline Margin	Distillate Margin
1977	—	36.5	28.5	—	8.0
1978	—	37.9	29.7	—	8.2
1979	64.2	55.6	42.2	22.0	13.4
1980	96.3	81.2	66.8	15.1	14.4
1981	109.9	100.7	84.9	25.0	15.8

Source: Monthly Energy Review and Lundberg Survey.

6. Policy Discussion

There are a number of energy policy issues raised by the fee proposal. In the short response time available, we have attempted to identify some and describe them.

* The fee exacerbates the pricing differences between oil and natural gas.

A homogeneous energy policy would be facilitated if greater parity existed between natural gas and petroleum. Yet the fee enlarges the gulf between oil and gas policy on several fronts. First of all, it would raise the price of oil even further above that of gas. Not only would gas consumers emerge as

CRS-11

relative winners (and oil consumers as relative losers), but it would distort investment decision making in firms that have to choose between funding programs in gas and oil development. Gas now appears to be in more abundant long term supply, and by creating greater incentives for oil than gas development, the wrong policy signals may be generated.

* The fee exacerbates the differences in tax policy between the competing fuels.

Then there is the dichotomy between oil and gas regulatory policy. Oil is unregulated and taxed by WPT. Gas is price controlled and not taxed as heavily as oil. The fee widens the differences inherent in this approach, by taxing oil even more heavily. It creates a situation wherein not only is the price gap widened—against a policy backdrop where price equivalency is an ostensible goal—but the "tax gap" is enlarged as well.

* The fee results in small import savings at great cost.

If all the fee and attendant increases in domestic petroleum prices ultimately accrued to individuals, the \$2 per bbl fee would cost about \$30 per capita in higher fuel prices, either directly or indirectly. This would result in import savings of 36.5 to 73.0 million bbls yearly at a cost of over \$11 billion.

* In order to generate relatively small amounts of Treasury revenue, much larger revenue flows are created.

Every dollar of Treasury revenue raised directly from the fee comes at a cost—measured in terms of higher fuel bills—of \$3. This raises the question of whether an excise tax on crude oil or refined products might be a more equitable and efficient way to raise Treasury revenues and achieve conservation. A change in the rate of WPT could achieve similar revenue goals. And if there is an excise tax on oil, symmetrical treatment could be called for regarding natural gas.

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REVENUE AND MACROECONOMIC IMPACTS OF AN OIL IMPORT TAX:
A BRIEF REVIEW

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April 6, 1982

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I. The Oil Import Tax Proposal

Projected large Federal deficits and consequent large revenue needs have focused Congressional interest on possible sources of revenue, including the imposition of a tax or fee on imports of petroleum.

Proponents of such a tax say that it will have the following desirable results:

- * Yield significant revenues;
- * Reduce the level of petroleum imports from what it otherwise would be;
- * Maintain incentives for domestic oil production and development of alternative energy sources, and
- * Maintain incentives for energy conservation, including the purchase of energy-efficient machinery and equipment.

Opponents of an oil import tax say it will have the following undesirable results:

- * Add to inflation or offset the current improvement in price trends;
- * Retard any economic recovery by increasing the costs of living and of doing business;
- * Impose a disproportionate hardship on low-income families, while at the same time increasing domestic oil company profits; and
- * Diminish the international competitiveness of U. S. industry.

This report outlines the results of a preliminary analysis of the economic impacts of oil import taxes set at flat rates of \$2, \$5, and \$10, respectively, per barrel of petroleum imports (both crude oil and refined products). A government charge levied on imports of a commodity has the same economic effect whether designated a "fee," "tax," or "tariff."

CRS-2

II. Market Reactions to the Tax

Buyer and seller reactions to the imposition of an oil import tax determine the ultimate economic consequences of such a tax.

- * The price to U. S. refiners of imported petroleum will tend to rise initially to include the amount of the tax.
- * Domestic oil producers will move to increase their prices toward that of imported petroleum; their profits will increase. In a reasonably competitive market, all sellers will charge about the same price for the commodity as that charged by the highest-cost supplier (in this case, importers), but for quality and transportation differentials. In periods of substantial supply, overall prices in the market may fall.
- * Domestic buyers will not be willing, or able, to purchase as much petroleum at the new higher price as before; demand for petroleum will decrease.
- * Because imports are the marginal source of oil in the U.S. market, virtually all of the decrease in U.S. demand for petroleum will be absorbed by sellers of foreign oil.
- * Sellers of foreign oil and domestic oil producers will lower their prices somewhat in order to attract buyers and to minimize the decrease in sales resulting from buyer resistance.
- * If suppliers have greater potential elasticity of response to prices than buyers, then the incidence of the tax will fall more heavily on buyers, and a greater proportion of the tax will be passed through to consumers.
- * Costs and prices of other goods and services will be directly and/or indirectly affected by the ultimate change in petroleum prices; and buyers and sellers of these other goods will react in much the same manner in an expanding "ripple" effect of decreasing intensity.

III. Assumptions Used for Revenue Estimates

Estimates of the revenue yield to the Federal government as a result of an oil import tax depend considerably on one's assumptions concerning import levels,

CRS-3

but also concerning the incidence of the tax — and, therefore, on the relative reactions of producers and users of petroleum to price and quantity changes in the market. It is particularly uncertain how oil producers will respond; much more is known about buyer reactions.

- * CRS has projected that imports of crude oil and petroleum products without an import tax will run an average of 5.15 million barrels per day in the second half of 1982, 5.40 million barrels per day in 1983, and 5.50 million barrels per day in 1984. We project that the stimulating effect on petroleum consumption of a moderate economic recovery is likely to be largely offset by the ongoing decrease in oil use per dollar of economic activity.
- * Price and quantity changes resulting from the tax are assumed to be determined simultaneously. This means that the estimates are able to take into account the interaction of the tax, oil prices, and the quantities of petroleum demanded and supplied—at the same time. Owing to the uncertainty of producer response, CRS has used two assumptions concerning incidence: (a) one half of the import tax would be shifted forward to buyers; (b) two-thirds would be shifted forward. Prices of domestic oil would rise in tandem.
- * Federal revenues from taxes other than those related to oil are assumed to decrease by an amount equal to the decrease in corporate profits due to the higher cost of petroleum, times the average effective marginal corporate income tax rate (estimated at 40 percent). The effects on corporate profits of changes in the level of economic activity resulting from higher petroleum prices were not taken into account, because of lack of time.
- * The price of crude oil in the U. S. without an oil import tax is assumed to be about \$30 per barrel and to remain at that nominal level for the next two years.

Assumptions by Other Estimators

Energy Information Administration²:

Petroleum imports:	1982	5.25 million barrels per day
(without a tax)	1983	5.30 " " " "
	1984	6.15 " " " "

* Energy Information Administration, U. S. Department of Energy. Memorandum, Economic Impacts of an Oil Import Fee. March 19, 1982. 3 p. plus tables.

CRS-4

Incidence of tax: Not explicit, because econometrically determined.

Base case price: \$30 per barrel of crude oil

Congressional Budget Office⁺:

Petroleum imports:	1982	5.00 million barrels per day
(without a tax)	1983	5.70 " " "
	1984	5.90 " " "

Incidence of tax: Two-thirds of the tax shifted forward to buyers.

Base case price:	1982	\$33.50	Refiner acquisition
	1983	\$33.63	cost of
	1984	\$36.90	crude oil

Joint Committee on Taxation[#]:

Petroleum imports:	1982	\$5.60 million barrels per day (second half)
(without an tax)	1983	\$7.20 " " " "

Incidence of tax: Not explicitly, because econometrically determined.

Base case price:	1983	\$35.39	Weighted average
			of crude oil and product prices

IV. Revenue Effects

In this preliminary analysis, the net gain in Federal revenues resulting from the hypothetical oil import taxes are estimated to equal --

- * Yield from the oil import tax, plus
- * Additional oil windfall profit tax revenues, plus
- * Additional corporate income tax receipts from domestic oil producers,
- * Less the decrease in corporate income tax receipts elsewhere in the economy resulting from reduced profits caused directly by the higher cost of petroleum.

Estimates of the oil fee's impact on the Federal budget in a broader macroeconomic context, taking account of its effect on the inflation rate and on the economy's growth are presented in Section V.

⁺ Congressional Budget Office, U. S. Congress. Memorandum, Oil Import Fees. March 22, 1982. 6 p.

[#] Joint Committee on Taxation, U. S. Congress. Preliminary estimates, received by telephone. March 16, 1982.

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CRS-5

Government revenues are estimated to be somewhat smaller when the passthrough of the oil import tax into prices to users is greater, because tax collections from domestic corporations other than oil producers decline by more than the increase in tax collections from oil companies. This is partly because the oil import fee itself comes largely out of profits of oil-using corporations. Revenues from the oil import fee also would be smaller because of the suppressing effect of higher oil prices on oil consumption and imports. Not included in this analysis, however, is the extent to which oil-purchasing industries would be able to pass their higher oil costs through into the prices of their own outputs.

ESTIMATED NET GAINS IN FEDERAL REVENUES FROM SELECTED OIL
IMPORT TAXES WITHOUT MACROECONOMIC EFFECTS*
(Billions of dollars)

INCIDENCE ASSUMPTION, AND PERIOD	LEVEL OF TAX (per barrel)		
	\$2	\$5	\$10
<u>One-half of Tax Passed through into Price to Users</u>			
Second half of 1982	1.7	4.3	8.4
Full year 1983	3.5	8.5	16.4
<u>Two-thirds of Tax Passed through into Price to Users</u>			
Second half of 1982	1.7	4.2	8.2
Full year 1983	3.4	8.3	15.8

* CRS estimates.

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V. POTENTIAL MACROECONOMIC EFFECTS

This section of the report describes the potential macroeconomic effects of imposing a per barrel oil import tax on all crude oil and oil products entering U.S. ports. Taxes of \$2, \$5 and \$10 per barrel are assumed to be in effect from 1982:1Q through 1984:IVQ. Selected measures of aggregate economic activity with the tax in effect are compared with those that would exist in the absence of the tax (BASE).

A. The Analytical Framework

A per barrel import tax on foreign crude oil raises the cost of crude to refiners. The immediate consequence of the resulting higher price would be a fall in the quantity of foreign crude oil demanded and an increase in the demand for cheaper domestic crude oil for which there is no tax.*

Because of an inadequate supply of domestic crude oil to accommodate this increased demand, upward pressure is exerted on the price of this oil as well. In the market for refined petroleum products the effects of the import fee depend, as explained above, on the sensitivities of oil buyers to price changes and of sellers to changes in consumption. For analytical simplicity, this analysis assumes that the complete tax (dollar for dollar) is passed on to refiners but the extent of passthrough to end users of petroleum is determined by the econometric model.

Industries within the United States that are energy-intensive would experience a rise in the cost of production that would lead to a contraction in their sales and employment. As prices of crude oil and petroleum products increase there would be a temporary rise in the general rate of inflation as many firms

*/ Of course, reduced demand for imported oil may induce foreign producers to lower prices in order to help prevent a drop in their market share. In this situation, there is less upward pressure on the demand for domestic crude oil and, consequently, reduced pressure on prices of petroleum products.

CRS-7

are unlikely to be able to substitute other factor inputs for oil at a sufficient rate to offset the rise in the cost of energy inputs.

Higher rates of inflation combined with resulting higher rates of interest retard real economic growth and reduce the level of industrial production and employment. The effects on the Federal budget deficit may be indeterminate for the following reasons. While the increase in Federal tax receipts that accrues from the imposition of a fee contributes to a lower deficit, these gains may be offset to a considerable degree by the budget effects of higher inflation and slower economic growth. The increase in inflation raises the dollar value of Federal Government expenditures for programs that are indexed to the rate of inflation. At the same time, the reduction in real economic growth reduces the level of tax receipts, so that it is entirely possible that the Federal Government's deficit ultimately could rise as a result of these initiatives.

B. The "Base" Economy

The baseline economy is characterized by the following assumptions that are represented in the Data Resources Inc. (DRI) model (CONTROL 03/22/82).

- * The economy shows strong economic growth beginning in the third quarter of this year, that is sustained at an average rate of 4.1 percent per annum thru the end of 1984.
- * Inflation rates as measured by the consumer price index for urban consumers average 6.4 percent per annum over the three year period, while the three month U.S. Government treasury bill rate declines to 9.9 percent by the end of 1984.
- * Unemployment rates decline steadily from an expected high of 9.2 percent in 1982 to 7.9 percent in 1984.
- * As the economy gains strength, the Federal Government's deficit declines, albeit modestly, from \$136 billion in 1982 to \$129 billion in 1984.

C. The Results

The economy under the proposed oil tax scheme was simulated using the DRI macroeconomic model for the period 1982:IQ through 1984:IVQ. The incremental

CRS-8

changes from the BASE case for selected measures of economic activity are shown in the Appendix -- Table 1 and Charts 1 thru 9. The imposition of an oil import tax on crude oil entering the United States is considered to have the following effects:

- * The slowing or declining trend in prices for gasoline and oil is likely to be reversed. When a \$2 fee is imposed, prices of gasoline and oil as measured by the implicit price deflator for this category increase by 3.0 percent in 1982 and by 3.9 percent in 1984. These rates jump to 15.4 percent in 1982 and 20.5 percent in 1984 when a \$10 fee is imposed. (Table 1)
- * The decelerating trend in inflation is likely to be partially reversed. A \$2 per barrel fee raises the consumer price index for urban consumers by 0.3 percentage points in 1982 and by 0.6 percentage points in 1984. For a \$10 per barrel fee, inflation is higher by 1.3 and 2.9 percentage points in 1982 and 1984 respectively. (Table 1 and Chart 1)
- * Higher rates of inflation stemming from a \$2 fee reduce real GNP by 0.2 percentage points in 1982 and 0.6 percentage points in 1984, and for a \$10 fee by 0.8 percentage points in 1982 and 2.7 percentage points in 1984. (Table 1 and Chart 3)
- * A reduced level of economic activity exacerbates employment difficulties. Aggregate employment is reduced by 10,000 to 38,000 workers in 1982 through 1984 in the case of a \$2 fee and by 90,000 to 185,000 workers in the case of a \$10 per barrel fee. (Table 1 and Charts 4 and 5)
- * The effects on the deficit are mixed. During the first two years, the extra revenues that the Federal Government receives reduce the size of the deficit. During the third year, however, these gains are lost as the deficit widens. The increase in the deficit during the third year is related to the effects of inflation in raising Federal expenditures for programs that are indexed to the cost of living. Also, slower real economic growth reduces the flow of funds into the U.S. treasury. For a \$2 per barrel fee, the deficit is reduced by \$3.8 billion in 1982 and is increased by \$2 billion in 1984. For a \$10 per barrel fee these changes are \$19 and \$9 billion respectively. (Table 1 and Chart 6)
- * The reduced level of oil imports associated with an oil import tax helps reduce the level of aggregate imports resulting in an improved balance of trade. The real value of net U.S. exports is higher by 0.8 percentage points in 1982 and by 4.1 percentage points in 1984 under a \$2 per barrel tax. For a \$10 per barrel tax these rates increase to 3.8 percent and 19.1 percent, respectively, during 1982 and 1984. (Table 1 and Chart 7)

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Table 2. Simulated Effects of Alternative Oil Import Fees on Selected Economic Indicators*

	1982	1983	1984
Inflation (Consumer Price Index -- percentage point change)			
\$2/barrel	+0.3	+0.6	+0.6
\$5/barrel	+0.7	+1.4	+1.5
\$10/barrel	+1.3	+2.8	+2.9
Implicit Price Deflator (Gasoline and Oil -- percentage point change)			
\$2/barrel	+3.0	+4.2	+3.9
\$5/barrel	+7.4	+10.5	+9.7
\$10/barrel	+15.4	+21.9	+20.5
Industrial Production Index (percentage point change)			
\$2/barrel	-0.3	-0.7	-0.9
\$5/barrel	-0.7	-1.7	-2.2
\$10/barrel	-1.5	-3.4	-4.1
Real Gross National Product (percentage point change)			
\$2/barrel	-0.2	-0.4	-0.6
\$5/barrel	-0.4	-1.0	-1.4
\$10/barrel	-0.8	-2.0	-2.7
Total Employment (nonagricultural establishments -- change in thousands)			
\$2/barrel	-10.0	-12.0	-38.0
\$5/barrel	-20.0	-31.0	-36.0
\$10/barrel	-90.0	-66.0	-135.0
Unemployment Rate (percentage point change)			
\$2/barrel	0.0	+0.1	+0.2
\$5/barrel	+0.1	+0.3	+0.5
\$10/barrel	+0.2	+0.6	+0.9
Interest Rates (U.S. Government three month bills -- percentage point change)			
\$2/barrel	+0.03	+0.23	+0.44
\$5/barrel	+0.07	+0.56	+1.08
\$10/barrel	+0.14	+1.10	+2.10
Housing Starts (change in thousands of units)			
\$2/barrel	-3.0	-22.0	-32.0
\$5/barrel	-7.0	-54.0	-78.0
\$10/barrel	-14.0	-105.0	-147.0
Federal Government Deficit (change in billions of \$)			
\$2/barrel	+3.8	+1.4	-2.0
\$5/barrel	+9.4	+3.5	-5.1
\$10/barrel	+18.8	+6.8	-9.1
Net Exports of Goods and Services -- billions of 1972 \$ (percent change)			
\$2/barrel	+0.8	+2.4	+4.1
\$5/barrel	+1.9	+5.9	+10.1
\$10/barrel	+3.8	+11.2	+19.1

* Negative numbers indicate that the variable declines relative to the "BASE."

Source: Simulated effects generated with the aid of the Data Resources, Inc. Econometric Model.

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SIMULATING THE EFFECTS OF AN OIL IMPORT FEE
WITH THE AID OF THE DRI-MODEL -- TECHNICAL DETAILS

The direct effects of an oil import fee is introduced by add-factoring the refiner acquisition cost per barrel of imported oil (PCOF) by the per barrel fee. Because the DRI model has no built-in mechanism for computing the direct effects of an oil import fee on Federal government corporate tax accruals, these computations are prepared outside of the model. The direct effect on corporate tax accruals is input to the model by changing the effective corporate tax rate residual (RTCGFRESID). This residual is defined as the difference between the statutory corporate tax rate RTCGFS and the effective corporate tax rate RTCGF, so that

$$RTCGFRESID = RTCGFS - RTCGF \quad (1)$$

and

$$RTCGF = TCGF/ZB$$

where

TCGF = total corporate tax accruals, and

ZB = before-tax corporate profits

But

$$\Delta RTCGF^* = \Delta TCGF^*/ZB \text{ (asterisk represents the desired change)}$$

Finally, the change in the effective corporate tax rate residual RTCGFRESID is reduced by the desired change in the effective corporate tax rate $\Delta RTCGF^*$.

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Chart 1

POTENTIAL EFFECTS OF AN OIL IMPORT FEE ON INFLATION

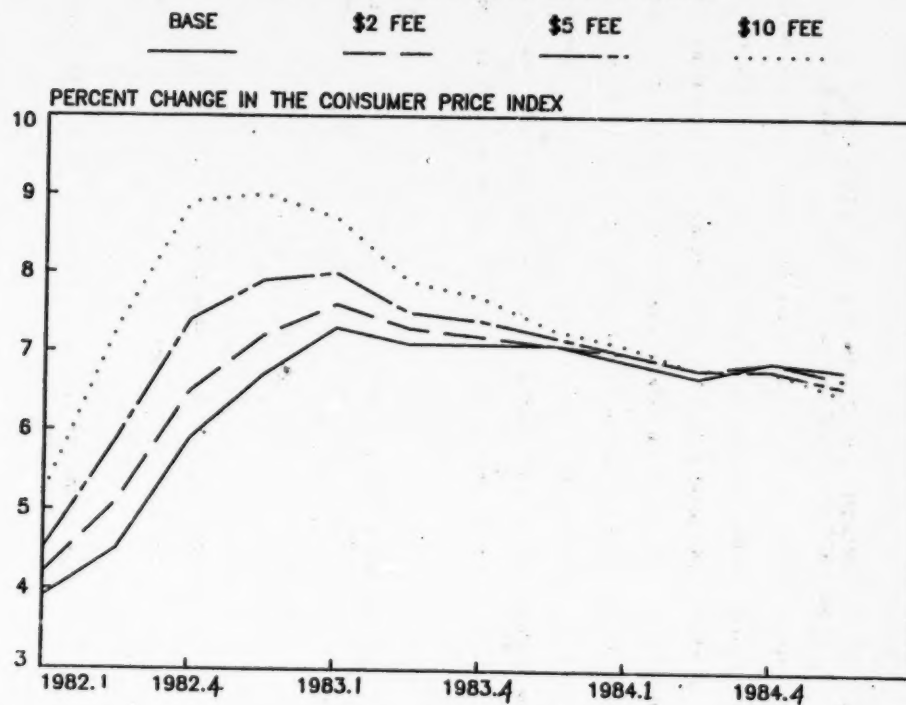


Chart 2

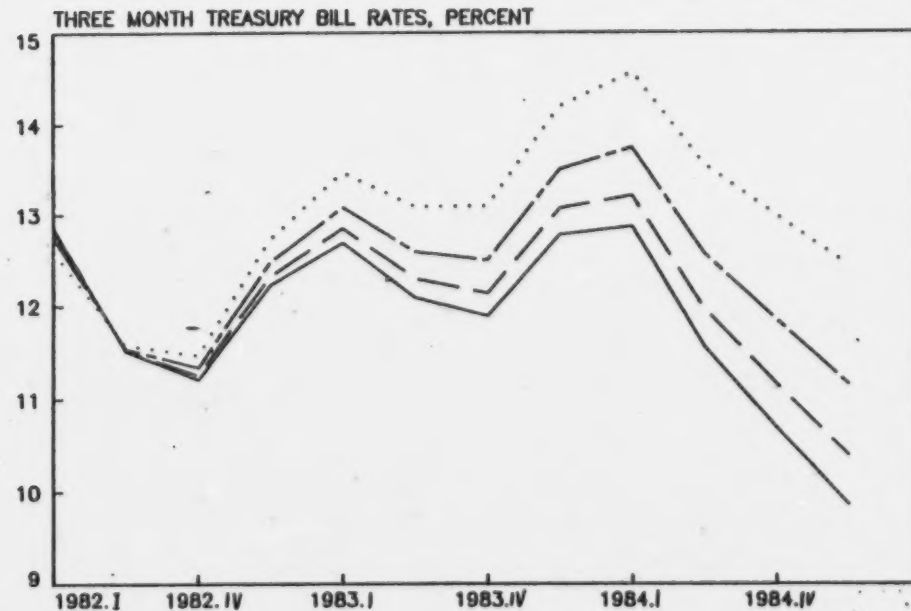
POTENTIAL EFFECTS OF AN OIL
IMPORT FEE ON INTEREST RATES

BASE

\$2 FEE

\$5 FEE

\$10 FEE



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Chart 3

POTENTIAL EFFECTS OF AN OIL
IMPORT FEE ON REAL GNP

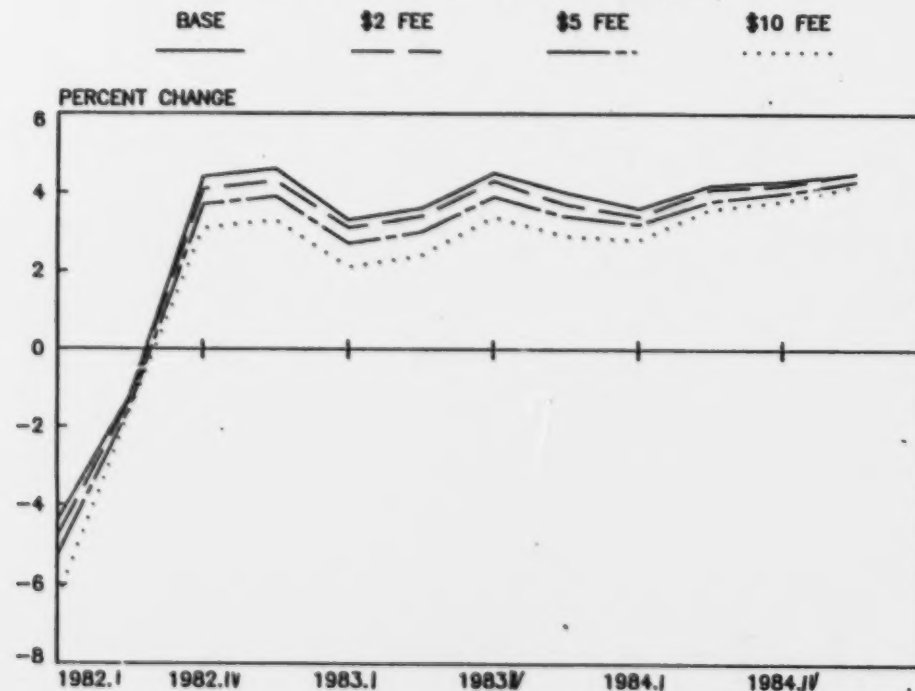
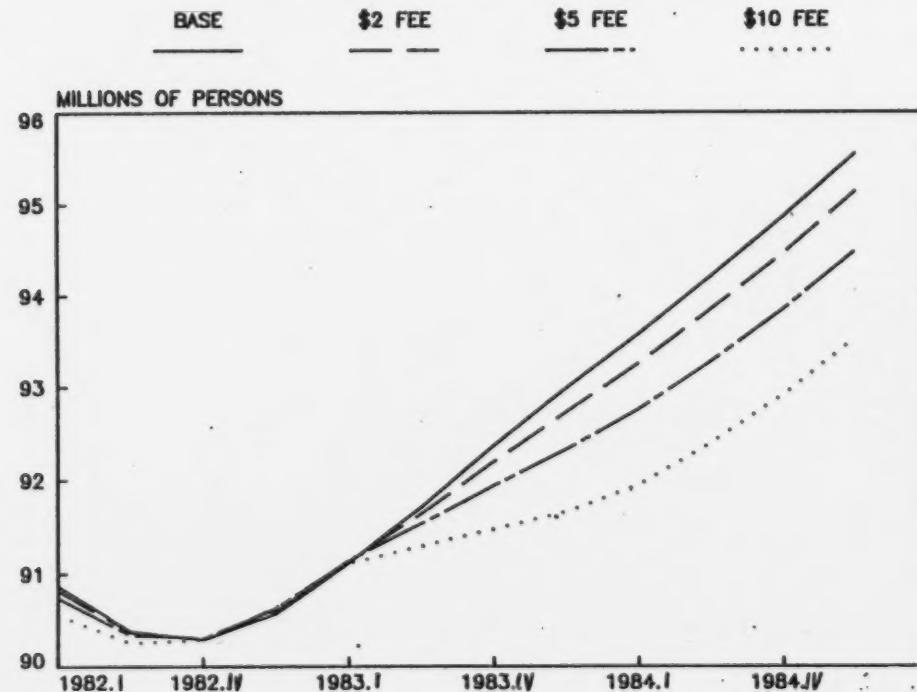


Chart 4

POTENTIAL EFFECTS OF AN OIL
IMPORT FEE ON EMPLOYMENT



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**POTENTIAL EFFECTS OF AN OIL
IMPORT FEE ON THE UNEMPLOYMENT RATE**

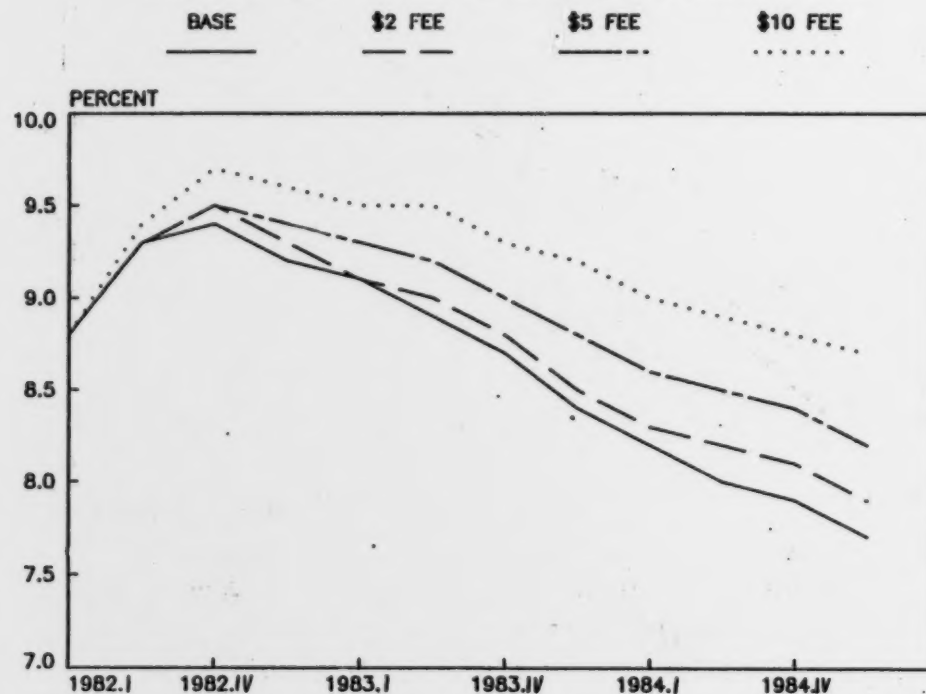
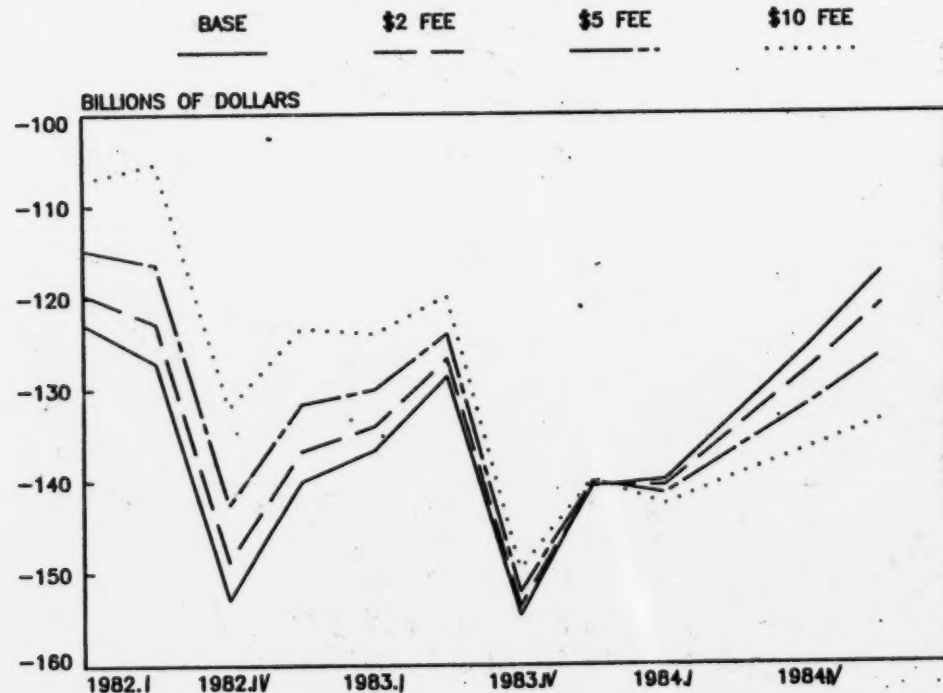


Chart 6

POTENTIAL EFFECTS OF AN OIL IMPORT FEE ON THE FEDERAL GOVERNMENT'S DEFICIT



123

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Chart 7

POTENTIAL EFFECTS OF AN OIL IMPORT FEE ON THE BALANCE OF TRADE

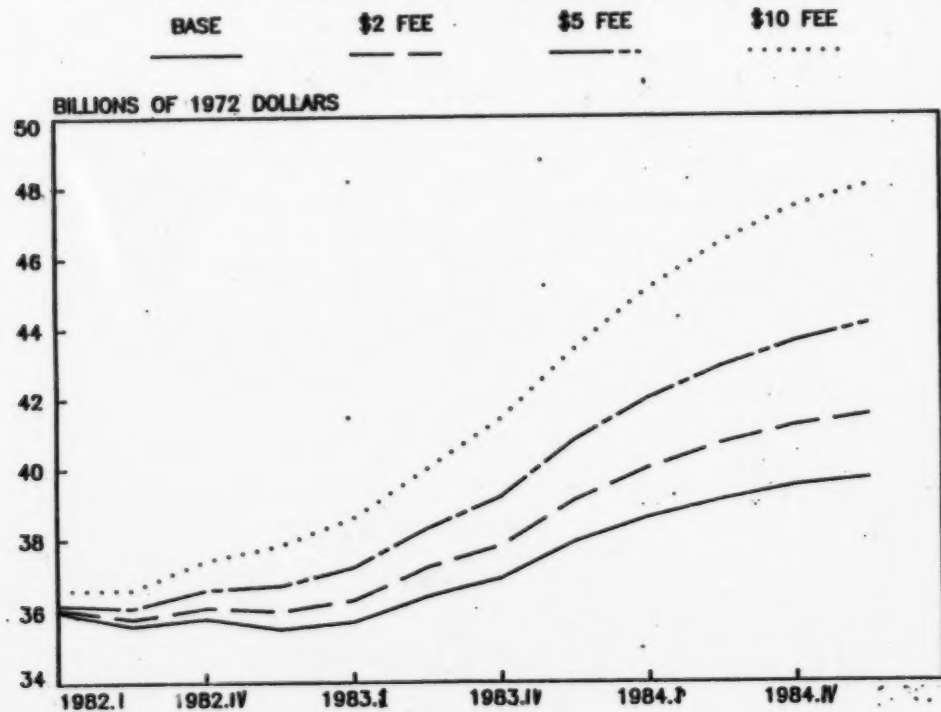
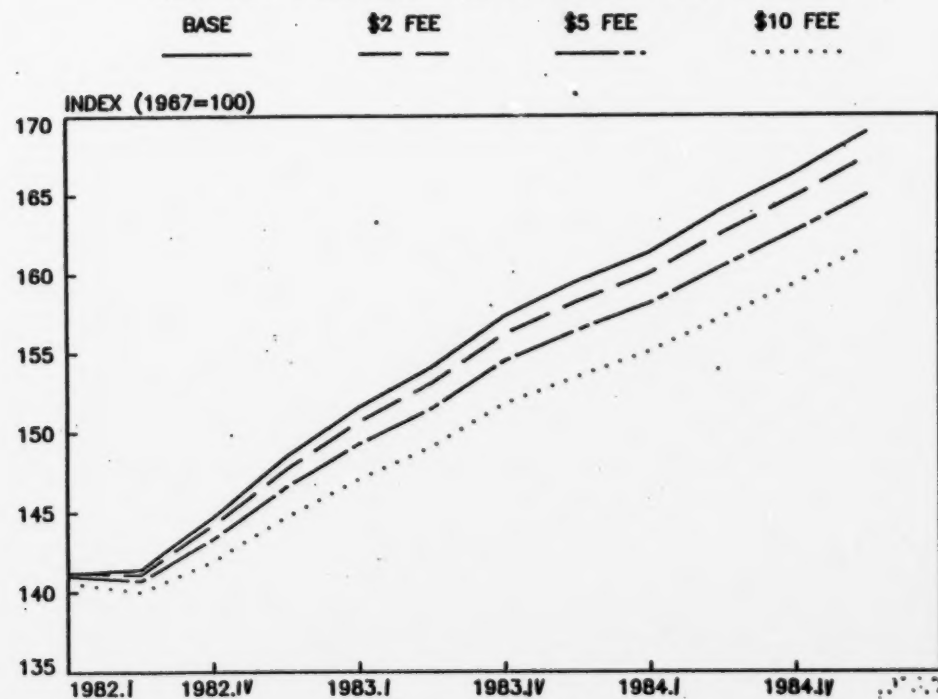


Chart 2

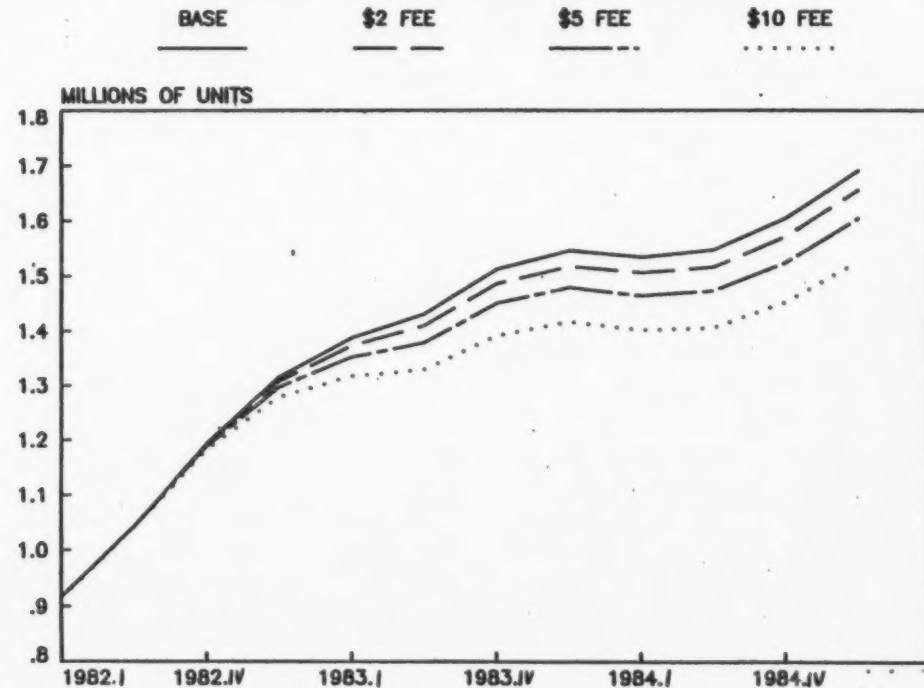
POTENTIAL EFFECTS OF AN OIL
IMPORT FEE ON INDUSTRIAL PRODUCTION

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125

Chart 9

POTENTIAL EFFECTS OF AN OIL
IMPORT FEE ON HOUSING STARTS



Mr. MOFFETT. You believe that the national security problems involved in imports would fall into that latter category; namely, that they represent real costs for the product which are not included in its price.

How does one go about assessing the level needed? Should other costs, such as environmental impacts or nuclear safety issues be treated similarly? If the goal is import reduction alone instead of revenue raising, wouldn't recycling the revenues gained from the fee into conservation and alternative production be more appropriate as well as less economically disruptive?

Mr. MONTGOMERY. I think, sir, that these are separate issues. That it is possible to make a decision about where revenue shall come from, and a decision about where the revenue shall go.

I would say the history of, for example, the windfall profits tax and the proposals that the windfall profit tax revenues should go into low-income energy assistance or the synthetic fuels trust fund or whatever, suggests that when money comes into the Treasury, it is in the Treasury, and it goes out from the Treasury. And I am not sure, given the incentive that a fee on imported oil creates for conservation, whether additional moneys for conservation and for alternative fuels are appropriate. But I would not link an import fee to funding for specific programs. Both need to be decided on their merits.

Mr. MOFFETT. The point has been made also about diversification of supply sources, and there is some thinking that diversification of supply sources may be more important than actually reducing the import level number. Despite a drop in imports, as I understand it, of nearly 32 percent in 1979 to 1981, dependence on Saudi Arabia as a percentage of total imports rose from 21 to 27 percent. In other words, we became more dependent on the fate of one country even while we were having a drop of imports overall.

Now, how would an overall import fee really address the diversity problem in your view?

Mr. MONTGOMERY. I am not familiar with those numbers. Let me turn to one of my colleagues. Maybe we can check to see who would like to handle that.

Mr. MOFFETT. What I am getting at, should there be a different national security premium assigned to imports from relatively secure areas—the Caribbean, for example—as opposed to more precarious areas, such as Algeria?

Mr. BOHL. I would not make the distinction. In my view, the world oil market is somewhat fungible, and it doesn't matter exactly where the United States buys its oil. What does matter is the distribution of sources to the entire market. Diversification of sources is important in that a larger percentage of oil that flows into the market comes from more secure areas, not less secure areas. It doesn't matter so much that the United States imports more oil from Saudi Arabia than it did before, but how the entire market depends upon Saudi Arabia relative to more secure sources.

The way the market has worked in the past, during past disruptions, it is fairly clear that the market does reallocate supplies among the buyers according to who is willing to pay the price.

Mr. MONTGOMERY. Perhaps I could amplify on that. One of the problems is the United States has relatively little leverage,

through its own decisions about where to purchase oil, on how much is produced for the world oil market by specific countries. If we think of the embargo of imports from Libya, someone else is taking that oil and the United States is taking oil from somewhere else. It might be if we tried putting a higher premium on oil from a secure source than an insecure area, it would mean we would take less, but the same amount would be in the market.

Direct action to support secure areas, for example, support for oil exploration in less developed countries, might contribute to the world's energy security, and so would multilateral action which attempted to encourage production in secure areas and take it out of the insecure areas. But I think the argument is that the United States is not a big enough part of the market to use its buying power very significantly to move oil around from one place to another.

Mr. MOFFETT. You would probably be opposed to the administration's decision not to support the World Bank's development program, I assume?

Mr. MONTGOMERY. Let me turn that to Mr. Broadman, if I might.

Mr. BROADMAN. Well, I am just beginning a large scale research project that would address in general, that very issue, and as a result I have not—yet—come to a definite concrete decision on that point. But certainly it would seem in the United States interest in terms of energy security, if it were to support multilateral financing or bilateral financing to promote exploration and development of petroleum resources in non-OPEC developing countries. There certainly is a strong energy security linkage there that justifies support.

Mr. MOFFETT. Mr. Montgomery, you are familiar with the study by the Petroleum Industry Research Foundation called "The Oil Import Fee Issue"?

Mr. MONTGOMERY. I am not certain. I have seen testimony by John Lichtblau, but I have not seen a larger study yet.

Mr. MOFFETT. At this time, without objection, the Chair will introduce that study into the record.

[The information follows:]



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New York, N. Y. 10168

THE OIL IMPORT FEE ISSUE

April 19, 1982

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Petroleum Industry Research Foundation, Inc.**THE OIL IMPORT FEE ISSUE**

There is a growing active interest among senior Administration officials and members of Congress in the imposition of an import fee on crude oil and refined products brought into the United States. The principal attraction of the fee for the Administration and its Congressional supporters lies in its revenue yield. The principal public justification for the fee is the presumed incentive it would provide for continued oil conservation, substitution and domestic exploration.

The revenue attraction is obvious. With an expected oil import level of about 5.5 million B/D of crude oil and products in 1983, each dollar in import fee would yield about \$2 billion annually in direct gross revenue. In addition, there would be considerable government revenue from the indirect effect of the import fee on domestic crude oil and natural gas liquids (NGL) prices. Domestic crude oil prices are of course directly related to the delivered cost of imported oil and would over time rise by approximately the amount of the import fee.

If we assume that the Windfall Profits Tax and the corporate income tax together skim off about 60% of any marginal price increase, each one dollar price increase in domestic crude oil would yield about \$1.8 billion in incremental annual revenue for the federal government. Increases in domestic NGL prices (which would be substantially smaller than those for crude oil) could raise this figure by roughly \$200 million for each dollar of the full import fee. Furthermore, the government's income

- 2 -

from oil royalties and the sale of oil from the Naval Petroleum Reserve would rise by some \$100 million annually for each dollar price increase.

Thus, if fully passed through, a \$5/Bbl import fee, the figure most frequently mentioned in recent reports, might cost oil consumers about \$29 billion annually and provide the U.S. Treasury with a gross revenue of \$20-21 billion, divided about evenly between the import fee itself and windfall profit and corporate tax payments. However, as we shall see, the net revenue from all sources accruing to the Treasury in consequence of the imposition of such a fee would be considerably less, due to the significant negative effects which the oil price increase would have on sectors of the economy other than energy production.

The argument that an oil import fee is required to assure continuation of the trend to reduce U.S. dependence on foreign oil has been greatly strengthened by the actual price declines of the last 12 months--U.S. refinery crude oil acquisition costs dropped from a peak of \$37.48/Bbl in March 1981 to an estimated March 1982 level of \$33/Bbl--and the predictions by some analysts of further price reductions in the near future. Prior to this development, the price of oil to U.S. refiners had increased consistently, though unevenly, since 1973 due to the combination of foreign price increases imposed by OPEC and the controlled rise of domestic crude oil prices towards the foreign level. From April 1973 until April 1979 an oil

- 3 -

import fee was actually in effect, at the President's direction but from the beginning of 1974 on it was too small relative to the price of imported oil to have any measurable effect on domestic demand nor was it intended to do so.

Until recently there was some concern that a substantial import fee would be considered a hostile action by OPEC which might react by raising its price by the same amount or more. Since OPEC's price structure was generally firm until about mid-1981 because commercially available excess production capacity was relatively small, the organization might have been able to carry out such action without a significant loss in export volumes--at least in the short run. Currently, this is of course not the case. OPEC will do well in the near future if it can keep its prices from sliding further. OPEC members are therefore not in a position to react to a U.S. oil import fee by raising their export prices. However, they would probably view it as a hostile measure directed against them, as some of their spokesmen have already indicated.

Most advocates of the import fee as an energy measure view its potential impact on OPEC as a by-product of its principal purpose which is to counteract the economic impact of the drop in foreign oil prices on domestic energy consumers and producers. The logic underlying this purpose cannot be faulted. Obviously, a continuing decline in the price of imported oil would over time cause domestic consumers to consume more and producers to explore less, leading to an eventual increase in the level

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- 4 -

of oil imports over what it would have been in the absence of the price decline. Equally obvious, an import fee would offset the impact of declining foreign oil prices on domestic supply and demand to an extent determined by the level of the fee.

But the fee would also constitute a major market intervention by the government for the purpose of redressing or preventing a market-oriented economic development. Since such interventions inevitably distort the existing market balance and, to judge from considerable historical evidence, do not inevitably achieve their desired goals, the oil import fee should be carefully examined prior to its imposition, regarding its economic cost, its effectiveness, its equity, the urgency of the need for it, and whether it is superior to alternate measures which could achieve similar results. In the following discussions we propose to do this.

Economic Cost of the Import Fee

If the fee is fully passed through to consumers and foreign suppliers do not absorb any part of it through offsetting price reductions while domestic oil producers raise their price by the full amount of the fee, a \$5 import fee would cost oil consumers \$29 billion in its first full year. Partial absorption of the import fee by foreign suppliers would of course blunt its impact on oil conservation and exploration but this is unlikely to occur on a significant scale. Given oil's observed

- 5 -

very low short-term price elasticity of demand, a \$5/Bbl crude price increase, resulting in average increases of about 12% in products retail prices*, would reduce U.S. oil demand by only around 250,000 B/D in the first year of the fee's imposition and only slightly more in the second year. Given the 25 million B/D of global oil trade, this is far too small a volume to cause foreign producers to risk lowering their prices to all customers in order to maintain their sales volume to the U.S.

Domestic oil producers, all of whom are producing at capacity, would want to raise their prices by the full equivalent of the import fee. However, if the crude market remains soft, as we expect it to be for the next several years, these price rises are likely to be instituted with a lag. This would be in line with the domestic producers' recent and current price policies and could temporarily raise the existing differential between foreign and domestic crude oil prices.

Domestic refiners, most of which currently operate under conditions of very low margins, would attempt to pass all foreign and domestic crude oil cost increases engendered by the import fee through to their product prices. Those refiners unable to do so may have to shut down capacity. Thus, over time, the

*Somewhat less for light products but significantly more for residual fuel oil.

- 6 -

full import fee and most of its maximum potential impact on domestic oil prices would have to be borne by consumers.

There are still other costs to the economy from the oil import fee. The ripple effect of the higher oil prices throughout the economy would increase the inflation rate in the first full year by about 1.3 percentage points, according to separate estimates by the U.S. Treasury and a well known private economic consulting firm. If we assume next year's inflation base rate in the 6.5-7.0% range, a 1.3 point increase due to the import fee would be quite substantial. The ramifications of the rise in the oil price would also cause a slow-down in the general economic growth rate. For 1983 this has been estimated at more than 1 percentage point, assuming a \$5/Bbl import fee for the entire year, or a loss in GNP of nearly \$30 billion.

By and large, both the rise in inflation and the drop in the GNP would be limited to the first year of the fee imposition if there is no subsequent increase in the fee. However, there is one significant exception to this. The impact of the oil price increase on natural gas would initially be relatively modest but would grow steadily until 1985 when price controls will be removed from about 55% of all flowing gas under the Natural Gas Policy Act (NGPA). The average price of gas will be increasingly determined by free-market parity with those

- 7 -

oil products with which gas competes. Thus, the higher oil prices resulting from the import fee would permit correspondingly higher gas prices. We estimate the gas cost increase to consumers from a \$5 import fee at \$12-15 billion no later than 1985. Under the NGPA most of this increase would be accumulated by the unregulated segment of the U.S. gas producing industry. Hypothetically, up to 46% of this money could flow to the Treasury in the form of income taxes. Actually, the Treasury's net receipts in consequence of the gas price increase would be significantly smaller because of the inflationary and other negative economic impacts resulting from the higher gas price.

Gas would also be likely to benefit in the short run from the oil import fee. If the fee were to add \$5/Bbl to the cost of residual fuel oil, currently shut-in gas production would be able to displace the oil at short notice in some industrial plants and electric power stations.

Effectiveness of the Import Fee

One measure of the effectiveness, or ineffectiveness, of the import fee is the calculation by the Congressional Budget Office that a \$5 import fee would yield a net federal revenue of \$11-13 billion in 1983, if foreign producers absorbed no part of the import fee, which we consider likely. Since the gross cost of the fee to consumers in the first full year is \$29 billion, this would mean that of each dollar oil price increase attributable to the fee only 38-45¢ would go into the federal treasury. Thus, if the purpose of the import fee were to be revenue collection

- 8 -

it would have to be considered a very inefficient vehicle to do this.

The fee's effectiveness in offsetting the potential impact in the U.S. of declining foreign oil prices is likely to be seriously limited by both short-term and long-term considerations. As pointed out earlier, in the short term (up to 2 years) the response of demand to price changes is quite low, so that a \$5 import fee would reduce demand by no more than 1.5-1.8%. While this is not insignificant, it pales in relation to the market-induced 13% reduction between the first quarters of 1980 and 1982. Of course, the demand reduction would fall almost entirely on oil imports which might be reduced by as much as 5% by the import fee.

The long-run limitations on the effectiveness of the import fee are likely to result from uncertainty about its political longevity. The emerging political controversy over the fee proposal reflects in part the reality that some sectors of the economy would inevitably be hurt by it while others would benefit. Passage or imposition of the import fee would by no means end this controversy, as can be seen from an examination of the period 1957-1973 when the level of oil imports was controlled by the government. Since reliance on politically controversial legislation or policy is by its nature hazardous, private companies would probably be reluctant to undertake long-range projects requiring large capital investments if the economic feasibility of these projects

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- 9 -

depended on maintenance of the import fee existing at the time the project is considered. This reluctance to rely on the import fee for the pay-out of future energy investments would be even greater if the fee were to be imposed by the President under the National Security clause of the Trade Expansion Act* than if it were legislated by an act of Congress, since the President could reduce or remove the fee at his discretion.

Equity Considerations

Obviously, an import fee would benefit domestic crude oil producers. As we pointed out earlier, the bulk of the domestic crude oil price increase in consequence of the fee would go to the government in the form of taxes but the after-tax benefit accruing to the producer would still be significant. Furthermore, it would grow over time as the Windfall Profit Tax rate on new oil production declines (under existing legislation) and the cumulative volume of new production increases. For producers of deregulated gas the benefit would be larger per unit of output, since there is no Windfall Profit Tax on gas production.

Doubtless, the higher price would stimulate some additional drilling and, hence, probably bring forth some additional production. But the government-induced price increase would benefit an industry which has done exceptionally well, particularly since the removal of oil price controls in January 1981, and has operated at full

*He can do so without Congressional approval if the Secretary of Commerce makes a finding that unrestricted oil imports threaten to impair the national security. The Act does not permit the President to impose an import fee for any purpose other than National Security, such as revenue collection.

- 10 -

capacity and maintained satisfactory earnings throughout the current recession.

By contrast, several of the industries on which the price increase would impact negatively have done very poorly last year and are in worse shape, so far, this year. Prominent among these are the oil refining industry already mentioned, the airline industry, the trucking industry, the railroad industry, and the petrochemical industry. Electric power plants which use oil as a power generating fuel (about 9% of total U.S. generation but 20% at the east coast) would also be significantly negatively affected. So would heating oil distributors, particularly those who must compete with natural gas in their markets.

These industries can be expected to protest loudly and strongly against this particular distribution of the burden of the import fee, especially if the fee is perceived to be primarily a revenue raising measure rather than an oil conservation and production incentive. The advocates of the fee may point out to these industries that a \$5 import fee would not even fully offset the price drop in crude oil and most products which has occurred in the last 12 months. But the affected industries could reply that the recent price drop was quite moderate and was preceded by an explosive and unprecedented price increase between early 1979 and early 1981 which they had to absorb in full.

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- 11 -

Another equity consideration as well as an economic one is the impact of an import fee on U.S. foreign trade. Since it appears unlikely that Europe, Japan or Canada will take steps to raise their oil costs above the world price level, most U.S. products will become less competitive internationally than they would otherwise be, for they generally have some direct or indirect petroleum component in their cost structure in the form of processing, heating or transportation. The competitiveness of U.S. products made in plants requiring natural gas, which is much more widely used than oil for industrial purposes, would also be increasingly negatively affected for the reasons explained earlier.

Another foreign trade consideration is the possibility of a conflict between the oil import fee and the President's recently proposed "Caribbean Basin Economic Recovery Act". The Act would permit duty free imports into the U.S. of most goods processed or produced in the Caribbean islands. Presumably, this would include oil products from the several Caribbean export refineries. If the import fee did not apply to these refineries they would have a substantial competitive advantage over domestic refineries as well as non-Caribbean foreign ones. This could obviously have far reaching consequences, both domestically and internationally.

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- 12 -

Urgency of Import Fee

There is little disagreement with the proposition that a sharp decline in the price of imported oil would in time create disincentives to domestic exploration as well as to oil conservation and substitution. An import fee may be one viable approach to correct such a development. However, up to now--mid-April 1982--such a price decline has not occurred nor do we consider it likely in the near future. Here is the U.S. refiner acquisition cost for the month of March for the last four years:

U.S. REFINER CRUDE OIL ACQUISITION COST

	<u>\$/Bbl</u>	<u>% Change</u>
March 1979	13.70	
March 1980	26.80	+95.6
March 1981	37.48	+39.8
March 1982 (est'd)	33.00	-12.0

Since the March 1981 figure represents the peak of the price run-up which started at the beginning of 1979, the price reduction, so far, can only be described as a moderate drop from the all-time high.

There is no evidence that this price drop has encouraged consumption which has declined by 7-8% in the first quarter of 1982 and is generally projected to remain below the 1981 level at least in the second and third quarter and possibly also in the fourth quarter of this year.

There is also no evidence that the price drop has curtailed domestic exploration. In January-February 1982 total U.S. drilling activity was 40% above the same period of a year ago, as was

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- 13 -

exploratory drilling. At the end of March rotary rig activity was down 15% from the historic peak month of 1981 but was still 5% above the year-ago count.

It would therefore seem that there is no urgency as yet to impose an import fee at this time if the real purpose of the fee is to counteract the economic effects of falling oil prices. Some forecasters have predicted that oil prices will fall to under \$25/Bbl in the near future. If they are right and refiner acquisition costs really drop to that level for a sustained period the case for an oil import fee would be greatly strengthened. Meanwhile, we are about \$7-8 above it and there are some preliminary, tentative indications that prices may bottom out at or near the present level.

Import Fee or Excise Tax

Whether the Import Fee is the best approach to achieve the desired goal depends of course in the first place on what the desired goal is. If it is primarily the collection of general revenue so as to reduce the federal budget deficit, the case for doing this by levying a tax on one single commodity, particularly one which has a very unequal regional and per capita consumption pattern, is far from convincing. The fact that the price of this commodity has recently declined from its all time peak so that consumers presumably would not pay more with the fee now than they paid without it a year ago does not strengthen

- 14 -

the revenue-collection case for an oil import fee. There are many goods and services in the economy whose prices have declined or have risen less rapidly than the inflation rate. Anyone of these might be as good a candidate as oil to tax for the purpose of revenue collection. More importantly, the revenue collection justification for an oil import fee fails to address the basic question, namely why this method is superior to the traditional methods of tax collection, such as income taxes, business taxes, excise taxes, user taxes, etc. Is it because an oil import fee may not be perceived as a tax by those who would pay it?

To the extent to which the import fee is expected to carry out the dual task of offsetting the impact of declining oil prices and of generating revenue for budgetary purposes, it may be useful to compare it with recent proposals for an increase in the gasoline excise tax whose function would also be the dual one of revenue collection and oil conservation. (Legislatively the excise tax would have to be considered a revenue measure and would therefore require Congressional approval.)

A gasoline excise tax would of course have a smaller impact on the economy than the oil import fee because of its smaller base. Its direct effect would be limited to gasoline which accounts for 41% of total U.S. oil consumption. It would have no impact on any other fuel since gasoline does not compete

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with non-oil fuels. Within the oil market it could affect the demand for diesel oil, depending on whether the excise tax would be limited to gasoline or be levied on all motor fuels.

Obviously, the tax would not affect the price of domestic crude or of natural gas. Thus, it would have no incentive impact on domestic energy supplies and a lesser impact on total domestic oil demand than the import fee. Whether this limitation makes the excise tax more desirable or less than the import fee depends again on what these levies are expected to accomplish.

From the point of view of affecting oil supply and demand, a government levy on gasoline only would be less effective than an oil import fee. However, as a revenue collection device the excise tax is clearly superior, since every cent paid by the consumer flows directly to the Treasury. Thus, the \$11-13 billion net annual revenue which the Treasury could expect to receive from a \$5 import fee could probably be obtained from a gasoline tax increase of approximately 16¢/gallon*--only 4¢ more than the estimated price increase of every refined product which would result from the import fee.

From the point of view of equitable distribution of the burden imposed on oil consumers a gasoline excise tax may also be preferable. With 110 million automobiles for a population of 220 million and with regional averages of annual miles driven per car not

*The macroeconomic inflationary impact of the excise tax could be expected to reduce the net government revenue somewhat below the estimated gross excise tax revenue of \$14-15 billion.

fluctuating widely, a gasoline excise tax would probably represent a more equitable burden distribution than a fee on all oil products. The reason is that kerosene, heating oil, residual fuel oil and LPG consumption are all regionally very unequally distributed. Even within regions, as well as communities, some consumers rely totally on some of these oil products while others do not use them at all.

Regarding the desirability for an increase in the federal gasoline excise tax (the current tax of 4¢/gallon has been in effect for nearly a quarter of a century), it may be interesting to note that the American automobile industry would apparently welcome it. A Ford Company official was recently quoted in the press as saying "these declines in gas prices scare the hell out of me",* and the Chairman of the Chrysler Corporation made the following comment:

We'd better send a strong signal to the American car buyer that gasoline prices are going up. (A quarter-a-gallon excise tax would) restore the trend toward fuel-efficient cars and away from the gas guzzlers.*

The proposed oil import fee attempts to achieve two goals: to reduce the federal budget deficit and to encourage domestic oil and gas conservation and exploration. It proposes to do this through substantial direct government intervention in the U.S. energy market. The question which has yet to be answered is whether the expected benefits from this intervention would justify the inevitable dislocations resulting from it.

*New York Times, Sunday Financial Section, p. 48. March 21, 1982.

Mr. MOFFETT. The study suggests that the fee would reduce U.S. oil demand by only 250,000 barrels a day compared to a 25 million barrels a day global oil trade. The foundation considers this amount, and I quote, "Far too small a volume to cause foreign producers to lower their prices to all customers in order to maintain their sales volume in the United States."

Can you comment on that, and if you disagree with that conclusion, how much of a price reduction can we expect from a \$5 per barrel fee, in your view?

Mr. MONTGOMERY. I think we can expect a larger reduction in imports over the long run from a fee. I think that the long run elasticity of demand is considerably larger than the level which would lead to this conclusion. We are talking about at least a 10-percent increase in the price of oil, probably more than that.

Mr. MOFFETT. Have you done any analysis on that to back up your point?

Mr. MONTGOMERY. Yes; my colleague, Mr. Bohi, has recently published a book on studying demand elasticity.

Mr. MOFFETT. That is not necessarily directly on point, though, is it?

Mr. MONTGOMERY. I think there are two steps in the argument. The first one is that in the long run, after the response to this price increase has a chance to work out, we should see higher levels of import reduction. I don't have numbers—I just cannot do the arithmetic quickly enough, but I would imagine something on the order of twice that large as a reduction, in demand as that estimated by the Petroleum Industry Research Foundation, given the general uncertainty about what those levels of demand are.

But then, the next step is the question of what are the exporters going to do in response to that lower level of demand. And on that, there are a number of pieces of evidence. Personally, what I found most convincing is a study done by the energy modeling forum at Stanford University using a number of different models of the world oil market, embodying different types of assumptions about what the objectives and the behavior of oil exporters would be.

I cannot give their precise numbers about the effect of demand reduction on the world oil price, but they worked through this train of reasoning and argue that a reduction in oil imports would produce a change in the world oil price beneficial to the United States that would turn into an optimal tariff, ranging between I think \$5 and \$12. Am I right on those numbers, Mr. Broadman?

Mr. BROADMAN. \$7 to \$15.

Mr. MOFFETT. If we are interested in the import fee only as a means to raise revenue, why not just repeal the existing oil company tax subsidies and raise about \$10 billion in 1984? Why not do it that way?

Mr. MONTGOMERY. I have a certain fondness for a uniform tax code, which personally leads me to some sympathy for that. Our research really hasn't addressed the question, except peripherally, which is the extent to which domestic oil production also can serve to lower import levels, and thus should receive the same level of incentive as conservation.

I think as a revenue raising device, repealing the tax treatment could not provide a greater incentive for oil production. Imposing

an import fee would raise the domestic price and should have some effect in making production levels higher than they would otherwise be.

Mr. MOFFETT. Are you assuming that the tax breaks and particularly the latest tax breaks that we gave to the industry, represent incentives to produce?

Mr. MONTGOMERY. The only thing I had in mind was the proposal to impose a minimum tax in lieu of the expensing of intangible drilling costs. I am not familiar enough with the subject.

Mr. MOFFETT. Dr. Cooper.

Dr. COOPER. Well, there are three points I would like to make:

First, I think there is an internal contradiction on the one hand, we are big enough to do certain things with a tariff, but not big enough to restructure the market. There is no evidence to distinguish why we will be successful in one effort but not the other. And I would like to see careful consideration of how this market structure has changed. We heard that \$5 to \$10 a barrel was useful when oil was \$5 a barrel, when it was \$10 a barrel, \$30 a barrel. At some point we have to start analyzing the market and say at what level of imports, at what level of imports from OPEC has the market structure changed, and therefore, we do not need to consider these tariffs. I have not seen that analysis yet.

Second, I object to the assertion that \$5 per barrel is a conservative price tag. This is \$20 billion, three-quarters of a percent of gross national product. That is not a conservative price tag.

Finally, I object to the unspecified projection of some sort of future economic benefits, one assertion that at some point in the long run we may reap some benefits. While I hate to be accused as a consumer, of only looking at the short run, I would point out that since the decontrol of domestic oil and the increase in the world price of oil—roughly June 1979—we have had the highest rate of sustained unemployment and the lowest rate of sustained economic growth since the depression. And when we objected to those kinds of energy price increases, we knew we would suffer immediate, severe macroeconomic impacts. When we said that we were accused of being extremists and so forth.

I think the record is clear. We know what happens in the short run. We know there are significant negative economic effects. We are still, we believe, suffering from an energy price recession, which was compounded by certain fiscal and monetary policy. So I hate to trade very long-term future benefits guessed at by vague theoretical analyses for those immediate short-term negative impacts which I think the historical record will show are undesirable and certain to occur.

Mr. MOFFETT. Thank you.

Mr. Montgomery, just staying on this issue of domestic production for a moment. You state that domestic oil is being produced at insufficient levels and then go on to say a greater incentive is required than is provided by the world price.

What do you have in mind there? How much of an incentive is necessary? There is a suggestion that the companies currently are receiving insufficient incentives.

Mr. MONTGOMERY. I am not suggesting that their profits should be larger.

Mr. MOFFETT. I am not saying it to attack their profits. We are interested in getting more oil produced, and knowing whether the incentives have been put on the table are adequate. If not, where are the shortcomings?

Mr. MONTGOMERY. May I turn that over to my colleague, Mr. Bohi, who has done most of our work on the specific question of supply and demand response?

Mr. BOHI. I don't think an answer to a question like this can be given in terms of how much is enough, how much should somebody pay for something, how much profit should somebody receive for something. In my view, the question of whether the industry receives a sufficient incentive to search for and produce more oil is best measured by the industry's response to an increase in incentives. Does activity increase when the price rises.

I think that looking at the numbers, the answer is clear: The higher the price, the more they spend in terms of drilling.

Mr. MOFFETT. Is that clear?

Mr. BOHI. That is clear. As a matter of fact, it tracks so closely that the decline in the world price in the last 6 months has also been accompanied by a decline in drilling activity in this country.

Mr. MOFFETT. Why would someone like Mr. Baxter at the Justice Department suggest that companies are so awash in cash and capital that they cannot possibly spend it? It would be ridiculous in his view, to expect the companies to spend it in production. Therefore, we shouldn't be surprised when they go out and make acquisitions, both energy acquisitions and nonenergy.

Mr. BOHI. Well, I don't want to be a defender of the petroleum industry. I certainly don't want to be put in that position. But, I would like to remind you this is an enormously capital-intensive industry. It is nice to have some free cash floating around in the internal coffers when you have interest rates close to 20 percent. So if they are going to do anything, building another platform and so on, they have got to have a lot of cash.

The other thing is that costs of drilling are going up enormously. They have to search in more inaccessible areas, whether it is offshore, the overthrust belt in Wyoming, Utah, or up in the Alaskan area. So in that sense, it requires more of an incentive, more of a net return, in order to generate an incentive.

Mr. MOFFETT. How much of this import fee, though, would go for production incentives? Is there any way of estimating it?

Mr. BOHI. I agree. They are not going to see very much of the increase in the fee. Even though the price may go up by, I think the Congressman said by something like \$3.75, you still have approximately 60 percent of that going back into the Treasury because of the windfall profits tax and the corporate income tax. So we are talking more on the order of 40 percent of \$3.75, if that much.

Mr. MOFFETT. I would like to ask one more question on consumer impact and direct it to Mr. Sweeney, and then perhaps the others.

Mr. Sweeney, you suggested that an import fee could increase consumers' electric bills in New England alone by half a billion dollars. And the New England Congressional Institute has projected a total regional cost of \$2 billion a year from the fee. Are there

appropriate programs in place to help consumers and small businesses deal with those kinds of higher prices in your view?

Mr. SWEENEY. Deal with the higher prices of my product?

Mr. MOFFETT. Yes.

Mr. SWEENEY. I don't believe there is anything specifically in place that would help other than the small businessman perhaps making an arrangement with the company with whom he is dealing for a payment schedule, something like this. But I see no aid or no grants.

Mr. MOFFETT. My point is that we are seeing so many people on the margin—individuals, homeowners, people with fixed income, and small businesses on the brink of going out of business. We have seen record numbers of bankruptcies. What I am trying to establish here is that the import fee would be another rather serious blow, given the figures you have presented, especially with no assistance available.

Mr. SWEENEY. That is right. We have seen in our service territory, which does include among other cities and towns the city of Boston, we have seen a tragically increased amount of small businesses going out of business, and the concomitant loss of jobs for people working in the small businesses. We see very serious impact on—perhaps more so—on those on fixed income, because when you see an increase such as we have seen—let's just say we have the reverse from \$27 to \$36, which you had at one time—you see increases like that, there is no income for the people coming in that is increasing at that level. And it is a very difficult thing. I don't know how they are going to handle this kind of increase.

Mr. MOFFETT. On the same point, Mr. Montgomery, Resources for the Future last year published a study called "High Energy Costs Uneven, Unfair, Unavoidable," in which it was stated, and I quote, "The poorest Americans range highest in the percentage of income spent on direct purchases of energy and are least capable of adopting many conservation measures."

Now, given that, what response do you give when people charge that this import fee is regressive and anticonsumer and will help to increase the burden on people who really are powerless to do anything about it?

Mr. BOHI. I think we would respond there, there is no question that it is going to be a burden on income classes as well as regions. We would also hope that the same questions are raised when you consider any other budgetary option, whether it is an import fee, some form of income tax, or a reduction in spending, and how they affect income classes, regions, and so on.

There is no question that an import fee will have a negative impact. It is going to be regressive, and it is going to hurt the Northeast more. But in spite of all that, there is a justification for an import fee quite apart from the budgetary considerations, as an energy policy. And that is where we are coming from, not as a justification for reducing the budget deficit as compared to some other alternative.

Mr. MOFFETT. Thank you all very much.

Our next panel consists of Jack Blum, general counsel, Independent Gasoline Marketers Council; Thomas Van Arsdall, vice president for energy resources, National Council of Farmer Coopera-

tives; Phil Chisholm, executive vice president, National Oil Jobbers Council; and John Buckley, board of directors, New England Council.

The Chair introduced into the record a statement by the AFL-CIO, Ray Dennison, director, department of legislation, and a letter from the Air Transport Association.

[The information follows:]

American Federation of Labor and Congress of Industrial Organizations



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APR 16 1982

April 14, 1982

Dear Representative:

The AFL-CIO is opposed to any action that will result in the imposition of a fee on imported crude oil and petroleum products.

Our opposition is long standing, non-partisan, and based on our conviction that the tax would be unfair, inflationary and job destructive. On May 6, 1980 the AFL-CIO Executive Council called for rejection of a similar measure put forth by the Carter Administration calling it "inflationary and inequitable." The House of Representatives rejected that proposal by a vote of 335-34 on June 5, 1980; the next day, the Senate defeated it by a vote of 68-10.

Figures recently developed by the staff of the House Committee on Energy and Commerce reveal "that a \$5 per barrel import fee would add more than 1 percent to the inflation rate and would add as much as 12 cents a gallon to the price of gasoline and heating oil. In all, such a fee could increase consumer costs by as much as \$30 billion annually."

It is clear that this \$30 billion will be paid for by the moderate and middle income working people that were so inequitably short-changed by the Reagan Administration's 1981 tax cut. For a typical working family, the cost of gasoline alone would rise by \$100 a year wiping out about one-quarter of their 1982 tax reduction. For workers such as building tradesmen, who commonly commute long distances and travel between work sites, the costs would, of course, be much higher.

The \$10 billion anticipated revenue increase from the fee will be quickly dissipated by the added energy costs the government will have to bear, as well as added outlays caused by increased inflation and reductions in receipts due to job loss and lower levels of economic activity.

Thus, imposition of an oil import fee to help meet the budgetary mess caused by last year's tax giveaways to the wealthiest in our society will only add to the energy costs of American families already hard-pressed by inflation and soaring unemployment.

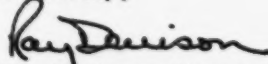
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- 2 -

If the Congress wishes to increase federal revenues by reducing the deficit, there are billions of dollars that can be raised by correcting inequities in last year's tax legislation and closing loopholes. The AFL-CIO has already presented the the Congress an equitable alternative tax program that could recapture nearly \$80 billion from the wealthiest individuals and the most profitable corporations and restore some semblance of equity to the nation's tax law.

The AFL-CIO urges that you reject any efforts to impose an oil import fee. The American consumer cannot afford nor should be asked to foot the bill for another round of windfall oil profits and tax injustice.

Sincerely,



Ray Denison, Director
DEPARTMENT OF LEGISLATION

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Statement of the Air Transport Association
of America on Oil Import Fees
U.S. House of Representatives
Committee on Government Operations
Subcommittee on Environment, Energy &
Natural Resources
April 27, 1982

The possible enactment of an oil import fee on crude oil and petroleum products has gained considerable attention in recent weeks. As Congress and the Administration attempt to resolve the budget deficit, interest in, for example, a \$5.00/b. import fee, as a revenue raising measure has increased. The thirty air carriers represented by the Air Transport Association (ATA) believe an import fee to be an inefficient revenue raising measure and to be highly inflationary. Such a fee will also have a severe financial impact on the U.S. airline industry, currently experiencing its worst financial period in history.

Recent studies by both private and governmental sources, including the Department of Energy (DOE) and the Congressional Budget Office (CBO), conclude that the net revenue from an oil import fee is far below what might reasonably be anticipated. As a result of economic dislocations such as reductions in the gross national product (GNP) and increases in unemployment, the net result of an oil import fee is substantially less than the gross amount projected to be collected. An import fee of \$5.00/b., combined with increased income from the Windfall Profits Tax, corporate income tax and federal royalties, results in gross revenues approaching \$30 billion in 1982. The net benefit to the U.S. Treasury, however, is estimated between \$11 billion and \$13 billion. With the ultimate recovery, therefore, being around \$.40 for each \$1.00 collected, the import fee is clearly an inefficient revenue raising measure.

-2-

While the U.S. Treasury's receipts will be far below that anticipated, the full cost will still be passed on to consumers. The Congressional Research Service (CRS), for example, estimates that a \$2.00/b. fee will increase fuel costs by \$50/capita. The inflationary effect of price increases of this magnitude are quite serious, particularly during a period of economic recession. Thus, the CBO estimates that a \$5.00/b. fee, which CBO does not assume will be fully passed through to consumers, could result in a .6 to .9% annual increase in inflation. A full passthrough would be equivalent to a 1.3% increase in the inflation rate.

The imposition of an import fee on crude oil and product would also wipe out the beneficial aspects to the airlines, among others, of the recent declines in the price of fuel. The CBO estimates that a \$5.00/b. fee could increase the price of petroleum products, such as jet fuel, by 8 cents/gallon. This would result in more than \$750 million in added annual airline costs. To recover these costs, airline fares would have to increase by about \$3.00 on every \$100 of ticket sales. Moreover, the CBO study, as noted above, did not assume a full passthrough of the import fee. If such were to occur, the price of jet fuel would increase by about 12 cents/gallon, adding over \$1 billion annually to airline expenses. Already, the airline industry faces a loss of \$1 billion for the 12 months ending June 1982. Thus, the imposition of an import fee would place a severe burden on the airlines and their customers at a time of extreme difficulty in the industry.

In conclusion, an import fee is inefficient and inflationary. It will have an adverse impact on the airline industry, as well as on every other petroleum-consuming sector of the economy. It is an unnecessary interference in the marketplace, and the Air Transport Association is strongly opposed to its imposition.

* * *

[Witnesses sworn.]

Mr. MOFFETT. Thank you for being with us.

Mr. Buckley, I would like to start with you. Without objection, any prepared statements you have will be included as part of the formal record. You may paraphrase, summarize, or proceed in any way you wish.

**STATEMENT OF JOHN G. BUCKLEY, BOARD OF DIRECTORS, THE
NEW ENGLAND COUNCIL, INC.**

Mr. BUCKLEY. Thank you, Mr. Chairman.

I would like to congratulate the Chair and the committee for holding this session today, and focusing on this issue which, while it may be ephemeral, is there. I am speaking today for the New England Council, a group of 1,400 companies involved in a broad spectrum of operations in New England. Because we in New England are 75 percent dependent on oil for our energy, not just imported, but domestic and imported oil, we have had a very difficult time competitively in recent years. We have been at the world price for our industrial fuel, to manufacture steam to run plants while other parts of the country which rely on other kinds of fuel, such as lower cost natural gas, have had a competitive advantage over industries in our area that run on oil.

It just strikes me as most unfair and devastating economically if New England companies, particularly those which are energy intensive—pulp and paper, companies of that sort—not only have to compete in the national market with a fuel that is still lower in cost, but have to compete in the international market at a price \$5 above the world price, while every other competitor will be at an energy cost \$5 lower. It has to mean jobs, it has to mean lower economic activity. But I think the New England and the Northeast case has been made.

I would like to point out in addition, there are tremendous inequities here even within States. You take a State like Indiana, represented on this committee by three gentlemen. There is a rural farm part of Indiana. Usually when you get to the rural areas you don't have big connections with natural gas pipelines. Farmers traditionally use propane, home heating oil for heat, diesel to get the crops in, use fuel to dry crops, certainly they need to cultivate crops and get them to market. Many of these farmers are in a very marginal position right now. They would be particularly hard hit, even though perhaps someone in a city, like Indianapolis, who heats with natural gas, wouldn't be hard hit.

Certainly those people who live in Los Angeles, where you use 3 percent sulfur residual fuel to generate electricity would be facing a couple of hundred dollars higher charge. And they have to drive. For someone living in San Francisco who heats with natural gas and rides BART, it might have a very low impact. So even within States and regions there are enormous inequities.

I think when you have a national problem, which we have with this budget, Americans are also ready to sacrifice. But when they are asked to sacrifice, they like to feel that the sacrifice is going to be evenhanded, that it is going to be roughly equal, that we are all

going to chip in, and not one guy chip in five times as much as another guy.

Quite apart from this equity argument, I think this is a very inefficient way to raise revenue. You get 35 to 40 cents on the dollar you collect. It is inflationary, as Dr. Cooper and others have mentioned. I think it is very bad international geopolitics. Fine, let's belt OPEC. They are kind of fraying a bit at the edge, their prices have been going down, why don't we belt them again? I don't believe that kind of 250,000 barrel reduction that John Lichtbau mentioned is going to do anything to OPEC except unite it, and it is not too united right now.

You saw on the front page today we are buying Iranian crude for \$4 or \$5 less than the OPEC official price, to place in strategic storage. If Iran and Iraq stop their war, there will be a lot of Iraqi oil. There is a good chance the Saudis may be able to hold the price. There is a good chance they may not. If you put this kind of thing on, I guarantee you, given the emotion, nationalism, and the direct challenge involved, they will have unity and make the price stick. And the next time there is a problem, which could be next week, or next year, they will stick it to us. They will charge the OPEC price plus \$5 to the United States because you already showed that you can afford to pay more.

Can we really be saying just because our import levels are down today, to get this economy moving again, we are going to have to import a little more oil, and when you look around out there in the world today, with the eyes of the world focused on the South Atlantic, you see trouble almost daily on the West Bank and southern Lebanon. You see Syria closing the border with Iraq and shutting off the Iraqi oil flow to the Mediterranean, you see Qadhafi urging the overthrow of the Saudi monarchy, Khomeini's troops driving Iraq out of Iran, and the Soviet troops massing on the Afghanistan border just on the other side of Iran. Who can say how long we are going to have a nice, quiet, restful, tranquil, and certain period of supply?

I cannot say that. We don't have any Emergency Petroleum Allocation Act; we don't have a plan to use our strategic petroleum reserves. We are quite vulnerable to go out and start saying let's belt OPEC and think they are going to absorb that \$5. They are not going to absorb a penny of it. The American consumer will.

It is bad trade policy. It runs directly counter to GATT. It will frustrate the President's Caribbean policy, which is supposed to have no tariffs. It is bad energy policy, and it is bad tax policy.

That is my summary. I appreciate you taking the rest of the statement for the record.

[Mr. Buckley's prepared statement follows:]

STATEMENT
of the
NEW ENGLAND COUNCIL
by
JOHN G. BUCKLEY

My name is John G. Buckley. I am a Vice President and Director of Northeast Petroleum Industries, Inc. of Boston. I am appearing this morning on behalf of the New England Council, as a member of their Board of Directors and a former Vice Chairman. The New England Council is an association representing 1,400 companies in the six state region. These companies are primarily in manufacturing, utility, insurance, banking, energy, high technology, professional services, education, health care, hospitality, wholesale and retail, transportation and construction businesses. They collectively employ over one million New Englanders.

The New England Council is deeply concerned that some Congressional leaders and Administration officials are considering the imposition of an import fee on crude oil and refined petroleum products as part of a package to reduce the federal budget deficit. The Council feels that the oil import fee is the most inflationary, inefficient and least equitable way to raise the tax revenues necessary to reduce the federal deficit.

I. Inflationary Impact

An oil import fee would sharply increase the price of imported oil. It would also raise all U.S. oil prices to comparable high levels because the domestic oil price would not remain significantly lower than the price of foreign oil. Therefore, a \$5 per barrel fee would increase -- by at least 12 cents per gallon -- the price of all petroleum products including gasoline, home heating oil, diesel fuel, aviation fuel,

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residual fuel and petrochemical feedstocks. Such increases would have a devastating impact on our member companies, significantly inflating their costs of operation.

In a study released last week, the Petroleum Industry Research Foundation, Inc. ("PIRINC") estimated that if fully passed through, a \$5 per barrel import fee would cost U.S. oil consumers about \$29 billion annually.^{1/} PIRINC further estimates that the ripple effect of the higher oil prices throughout the economy would increase the inflation rate in the first full year of the fee by about 1.3 percentage points and would result in a loss in GNP of nearly \$30 billion. These are indeed alarming figures! I ask that the PIRINC study be included in the Committee's record.

We are even more alarmed at the results of a recently completed study by the Congressional Budget Office ("CBO") which claims that a \$5 per barrel tariff would lead to additional unemployment of about 100,000 persons and would put further upward pressure on interest rates. I also respectfully request that this study be included in the hearing record.^{2/}

The CBO study points out that today's falling energy prices are contributing to a lessening of inflation. Just this

^{1/} Petroleum Industry Research Foundation, Inc., "The Oil Import Fee Issue," April 19, 1982.

^{2/} Congressional Budget Office, "Oil Import Tariffs: Alternative Scenarios and Their Effects," April 1982.

past week, in fact, the Labor Department reported that consumer prices fell 0.3 percent in March, the first month-to-month decline in 17 years. The major factor behind the decline in the cost of living, according to the Bureau of Labor Statistics, is the decline in energy prices; energy is, of course, a factor in nearly all products and services used in the index.^{3/}

II. Regional Impact

Because of its heavy reliance on oil, New England as a region would be severely impacted by an oil import fee. Businesses in our area are already at a competitive disadvantage vis-a-vis areas of the country where industry relies on lower cost, price-controlled natural gas.

Earlier this year, the Administration announced its intention to correct this inequity by deregulating the price of natural gas. Unfortunately, the final decision was subject to many delays, and the President missed the opportunity to take the most important and positive energy step of his Administration. That move alone would have raised \$39 to \$49 billion for the U.S. Treasury during the next three years even without a Windfall Profits Tax.

Now, instead of reducing the price disparities between oil and gas by taxing the lower cost fuel, natural gas, consideration is being given to an import fee which would

^{3/} See Washington Post, "Consumer Prices Down Last Month After 17-Year Rise," April 24, 1982 p. A1 and A7.

worsen the competitive position of businesses and consumers who use oil. The fee would be another blow to oil users who suffered two major price shocks in the 1970's and who only recently have begun to enjoy a little price relief.

While many New England industries would be severely impacted, some, like pulp and paper and wood products, may even be driven out of business. How can you expect a highly energy intensive paper company in Maine, facing oil costs \$5 a barrel above the world price, to compete against a Canadian or a Norwegian paper company producing the same products at lower costs? An oil import fee, by raising domestic energy costs above world price levels, will reduce the ability of all American firms to compete overseas with Japan, Germany, and other exporters.

While the adverse impact of the fee on New England is evident, it is equally clear that all regions of the country will pay heavily. The following table shows the impact on each region of a \$5 per barrel tariff.

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IMPACT OF OIL IMPORT FEE^{*/}

<u>Region</u>	<u>Petroleum Consumption (Millions of Barrels Per Year)**</u>	<u>Impact of a \$5 Import Fee (Billions of Dollars Per Year)</u>
New England	386	\$ 1.9
Mid-Atlantic	980	4.9
South Atlantic	1,023	5.1
East North Central	1,069	5.3
West North Central	516	2.6
East South Central	445	2.2
West South Central	1,118	5.6
Mountain	342	1.7
Pacific	878	4.4
TOTAL U.S.	<u>6,757</u>	<u>\$33.8</u>

*/ Based on State Energy Data Report, Department of Energy, September, 1981.

**/ Consumption figures for 1979.

III. Impact on the Natural Gas Market

A \$5 per barrel oil import fee could raise the price of decontrolled natural gas substantially. This increase would occur because the import fee is the equivalent of an increase of about \$.85 per Mcf for oil and propane, the fuels in direct competition with natural gas.

At present, decontrolled gas represents as little as 4 percent of national supplies. However, on January 1, 1985, a majority of all natural gas will be decontrolled. As a result, most experts believe that the average price of gas by 1985 will rise to approximately the Btu equivalence of oil. Therefore, by 1985, an oil import fee of \$5 will increase the average price of all natural gas by about \$.85 per Mcf, or about \$17 billion per year (20 tcf x \$.85 mcf). Without a Windfall Profits Tax on natural gas, very little of these increased costs to consumers will be recovered in increased federal revenues or a decreased federal deficit.

In addition, an oil import fee, by raising the price of oil and of decontrolled gas also raises the price which Canadian, Mexican and Algerian natural gas exporters can demand. The effective limit on the price of natural gas imported into the United States is the price of oil, which competes with gas. A \$5 per barrel import fee would therefore raise the potential price gas exporters could charge by \$.85 per Mcf.

An increase in the imported gas price threshold by \$.85 per Mcf creates a potential windfall for Canada, Mexico and Algeria as well as for domestic deep gas drillers and natural gas marketers in the United States. Gas users in the Upper Northwest and California will pay the higher Canadian prices; New England and Mid-Atlantic users will pay the Algerian prices; Texas, California and others will pay the higher Mexican prices.

IV. Conservation Impact

According to the CBO, the imposition of a \$5 per barrel import tariff would reduce U. S. oil consumption by 200,000 barrels per day in 1983 through substitution of other fuels and outright conservation. This is only 1.2% of current domestic consumption of 16 million barrels per day, and represents a modest decrease in usage at great expense to the economy.

Some Congressional leaders and Administration officials have tried to argue that falling oil prices will reverse the significant gains we have made in conservation and that a 200,000 barrel per day saving is worth the economic pains the nation will have to endure from a fee. What these policymakers fail to recognize is that oil consumers -- residential, commercial, agricultural, and industrial -- have made significant investments in energy saving measures that are permanent. The homeowner, for example, is unlikely to tear out the insulation he/she has installed and the commercial/industrial

establishment will not replace its energy efficient oil burning equipment with less efficient equipment.

The principal fact is that oil users have experienced the sharpest price increases since 1973 and they have finally, though painfully, accommodated to them; accordingly, they are unlikely to revert to old habits.

Finally, a recent study by John Trimble and Eric Hirst of Oak Ridge National Laboratory shows that oil users are using 22 to 32 percent less energy to heat their homes than are natural gas users in comparable houses and under comparable climactic conditions.^{4/} In short, an oil import fee would do little to encourage more conservation by those who have conserved less to this point.

V. Revenue Impact

Various estimates have been made of the impact of an oil import fee in reducing the federal budget deficit.

o The Energy Information Administration ("EIA") of the Department of Energy estimates that a fee of \$5 per barrel will have such a negative impact on the economy that the federal deficit will be reduced by only \$8 billion in 1982, \$7 billion in 1983, and \$1.2 billion in 1984.

^{4/} Eric Hirst and John Trimble, "Analysis of Household Primary Heating Fuel Consumption: Natural Gas and Oil," November 1981. A copy is being submitted for the Committee's record.

o The Congressional Research Services ("CRS") of the Library of Congress estimates that the adverse economic impacts of a \$5 fee might be so severe that the federal budget deficit (without windfall tax revenues) would actually be \$5.1 billion larger by 1984.

o The CBO estimates that the net budgetary effect of a \$5 per barrel fee could be to raise about \$10 billion for the U.S. Treasury in 1983 and 1984, but that there would be a .6 percent rise in inflation and serious increases in the cost of many government programs.

o The Consumer Energy Council of America ("CECA") estimates that more than half of the gross revenues from a \$5 per barrel oil import would be lost or offset. Thus, from a \$21 billion increase in the national oil bill, the net revenue gains of the fee would be less than \$8 billion.

Although they do not agree in all respects, these studies clearly demonstrate that an oil import fee would be one of the most inflationary and least efficient means of trying to deal with the current budget deficits.

VI. Conclusion

The New England Council is strongly opposed to an oil import fee. Not only is it a discriminatory tax that will impact unfairly on oil users and oil consuming regions, but it is an inefficient and inflationary means to achieve the Administration's goals of reducing the deficit. It is not fair to call on one energy consuming sector and certain regions to bear a national burden.

We wish therefore to express our support for the resolutions opposing the fee introduced last week in the House by Congressman Conte (R-MA) and Dingell (D-Mich) (H.Res. 430) and in the Senate by Senators Chafee (R-RI) and Mitchell (D-ME) (S.Res. 261) and The New England Council hopes that a majority of both Houses of Congress will go on record in opposition to an oil import fee.

Thank you very much.

Mr. Blum.

Mr. BLUM. My name is Jack Blum. I am the general counsel of the Independent Gasoline Marketers Council, which is a trade association of large nonbranded independent retailers of motor gasoline. Council members buy gasoline from refiners and resellers. They buy it from the cheapest available source.

Our most immediate financial concern, apart from our other concerns is that certain people will get a windfall as an import fee is imposed, and those are the people with domestic crude production. The history of the windfall is when you give those people a windfall, they turn around and use it on the street competitively to knock other people out of business. We have seen that happen before. We have seen it when the entitlements program under the controls ran amok. The people who had North Slope crude began to drive everyone out of business.

We think the competitive inequities that flow directly from an import fee, the giving of large sums of money to domestic producers, nets you nothing and creates chaos in the marketplace.

I might add as well, there is a competitive effect on fuel oil. Anybody in the business of distributing it in a region where there is natural gas is further competitively disadvantaged, probably put out of business, and not for any reason that benefits the Nation as a whole.

Having said that about commercial interests, I come here this morning with a feeling of déjà vu. The last time I testified before this committee was on an import fee proposal by the last administration. The last administration was proposing a 10-cent gasoline tax if you remember. My association and my law firm filed suit on that. The distinguished chairman was one of the plaintiffs. David Stockman was one of the other plaintiffs. Because at that time at least he understood full well the negative impact that such an import fee would have on consumers.

Mr. MOFFETT. He still does, I am sure.

Mr. BLUM. I should also say that this is a very old problem around town. And I begin to think there are a group of people at the Treasury Department who have an airplane hangar with a storage barn for turkeys, and every several years we get the turkey out and try to make the turkey fly.

When I first came to this city in 1965, my first fight was against an oil import quota which had been imposed at the end of the Eisenhower administration, ostensibly to prevent foreign imports of oil into the United States. The track record was that foreign oil continued to be imported, consumption continued to increase. By the time 1968 had rolled around, we had tripled our imports, and the major consequences was that the United States was paying twice as much as the Japanese for the same oil, which was destroying us competitively.

There was a terrible fight, because the domestic producers were getting a windfall and they did not want to give that windfall up.

We then had further attempts to impose fees. The Ford administration, dissatisfied with Congress energy proposal, came up with the idea of an oil import fee of \$1 a barrel the first month, \$2 a barrel the second month, unless and until President Ford got his way with the Congress on energy legislation. The meat of that was that it could be imposed by fiat, rather than by going through Congress. Congress saw fit to override President Ford's veto and tell him that was bad policy.

Now, this proposal turns up whenever administrations seem to face that awful moment of truth, which is that the budget has too little income and too much outflow. It seems to be a very convenient way of solving the budget problem. You can get around going to Congress by simply saying it is a matter of national security and then you can raise a lot of revenue quickly. And you get a built-in constituency, and the built-in constituency are people in the synthetic fuels business, and in drilling and production in the Southwest and the Far West.

I submit that we have had enough experience now to know even the Members who represent those people will—I am talking now about the Members of Congress—will look twice, because of the impact of import fees on their consumers and industry.

And it is not now just a question of producers. Mr. Buckley touched on the foreign trade aspects of a fee. I would just like to say that I believe that the imposition of any import fee would be a violation of our commitments at GATT. We have committed not to discriminate against imported products, except for reasons of national security. It seems to me that no one is saying this is being done for national security. It is purely a budgetary fix. It would in fact ruin the President's Caribbean initiative, which calls for a free trade zone with the Caribbean.

The product will come into the United States subject to a fee, and therefore, one of the major exports of that region will be subjected to a tax and a tariff which is outside the policy ambit of the administration.

There are many other options. I hate to talk about it this bluntly, but income tax after all, taxes the people who have the income, and on this level, I think the administration has been quite right, with some of its revenue enhancement proposals in suggesting cutting back on some of the benefits that now attach to oil well drilling, and some of its proposals for minimum corporate tax, I think, frankly, is the direction to go in, not in this direction.

There is another point. A sales tax on energy is not only horribly regressive, but it also takes the revenue away from the States. State and local governments use taxes, gross receipts taxes and sales taxes to raise the bulk of their revenue. On the other hand, this administration has talked about giving programs back to the States, has talked about giving back revenue bases. This is a key State revenue base, and it would be usurping that revenue base.

And I should remind you that in every State, for many institutions which have been under extreme financial pressure—I am thinking of colleges and universities, cities and towns—energy has been a principal cost of doing business. A college whose board I sat on was practically bankrupted by the energy costs, principally the increases in fuel oil costs over the last several years.

Even though Federal aid is diminishing, the cost of that fuel is going to go down, and we are in a little bit better shape. To see that turn around and go back up again as the Federal assistance goes down and as the economy goes sour, I think is ruinous.

That sums up what I have to say.

Mr. FRANK [presiding]. Thank you very much.

The chairman has been called away to a markup in the Energy and Commerce Committee.

Mr. Chisholm.

**STATEMENT OF PHILIP R. CHISHOLM, EXECUTIVE VICE
PRESIDENT, NATIONAL OIL JOBBERS COUNCIL**

Mr. CHISHOLM. Thank you very much.

I will be brief and just summarize my statement. I am Philip Chisholm, executive vice president of the National Oil Jobbers Council. Our membership represents 42 various State associations who in turn represent about 15,000 independent petroleum product marketers throughout the country. We estimate those marketers are selling about 85 percent of the home residential heating oil and 50 percent of the gasoline sold throughout the country.

The temptation this morning is to say "me too" to the remarks of Mr. Blum and Mr. Buckley, and several others who have testified this morning. There are, however, a couple of points that I would like to emphasize for the purposes of explaining the problems this import fee would place on our membership.

While we think it is bad economic policy, bad energy policy, bad foreign policy, we also think that the competitive aspects of the fee or the impacts on competition that the fee will have have been overlooked in many quarters. Mr. Blum touched on this briefly.

Looking at the way the import fee would be applied, we see many of our members, the small business marketers, as being very, very adversely affected in the way the fee would be passed through. Our competitive position vis-a-vis our principal competitors, the integrated oil companies and the gas utilities, would be devastating.

The major oil companies would have more flexibility in terms of passing the fee through. Some oil companies with high domestic reserves, as Mr. Blum pointed out, would have a great deal of flexibility they could exercise in the marketplace, that many independent marketers simply would not have.

From a heating oil standpoint, I need not tell you this is just another blow to the heating oil marketer who, in trying to compete with the natural gas utility, just cannot do it.

We are concerned about these competitive aspects simply because in the last year since gasoline and crude oil decontrol, approximately 800 independent marketers have gone out of business. We estimate there is approximately another 6,000 who are literally hanging by their fingernails, primarily because of the competitive conditions of the marketplace today and the generally deteriorating economy.

The second major concern we have with the import fee is the signal that this fee gives to consumers about conservation. One of the principal marketing tools many of our members have used to

stay competitive primarily with the gas utilities has been conservation, and as Mr. Moffett pointed out before he had to leave, New England has been a model of conservation, and many consumers have taken the steps they have had to take in response to the higher oil prices that have hit them. Now, those consumers are quote, unquote "rewarded by saying you have done a good job, but your price still is not high enough and we are going to raise it higher."

We think that sends a negative signal to consumers to conserve and most consumers will say:

Why should I, because the price of oil is going to reach a certain price and if we are successful in bringing it down through conservation, then the government will simply raise it to collect taxes.

The third point is we think that an import fee begs for regulatory structure to implement. We have just gotten out of a major regulatory program with the price and allocation regulations on gasoline and crude oil, and we think an imposition of an import fee will beg for some type of regulatory system to be put back in place on the entire industry. There is virtually no way to have an oil import fee without some regulatory system. There will be demands for entitlements, there will be demands for exceptions because of the inequities created by the fee, and it would seem rational, although we have done no economic analysis, to say that the same regulatory structure you need to keep prices \$5 below the market level is necessary to keep prices \$5 above the market level. There would seem to be some reasonableness to that approach.

Finally, I think it is important to recognize that we as small businessmen, in opposing the oil import fee, should in no way be seen as opposing efforts to reduce the Federal deficit. Our members are in a state of crisis right now. I heard a speaker cite some figures last week saying that 60 percent of the operating profits of small business in 1981 were eaten up by interest rates, and 45 percent of the cash flow of small businessmen were eaten up by interest rates. And we attribute a lot of that to the size of the Federal deficit, and we think something needs to be done about that.

We clearly believe the import fee is the worst possible alternative in dealing with that problem, and we think it is time to pronounce the last rites on this import fee once and for all, and then go on about the business of solving the budget deficit.

Thank you very much.

[Mr. Chisholm's prepared statement follows:]

TESTIMONY

by
Phillip R. Chisholm
Executive Vice President
National Oil Jobbers Council

PREFACE

The National Oil Jobbers Council is a federation of 42 state and regional trade associations representing thousands of independent small business petroleum marketers. Members include gasoline and diesel fuel wholesalers, commissioned distributors of gasoline, gasoline reseller-retailers and a large number of retail fuel oil dealers. Members also wholesale or retail many other petroleum products, including kerosene, LP gas, aviation fuels and motor oils as well as residual fuel oil. Together our members market approximately 50 percent of the gasoline and 85 percent of the home heating oils sold in America under either their own private brand or the trademark of their supplier.

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Good morning, Mr. Chairman and members of the Subcommittee. My name is Phillip R. Chisholm and I am Executive Vice President of the National Oil Jobbers Council (NOJC), a federation of 42 (see attached list) state and regional associations representing 15 thousand independent petroleum product marketers. We estimate that our members market 85 percent of the residential home heating oil and more than 50 percent of the motor fuels consumed in this country.

I am here today to once again express our fervent opposition to the imposition of an import fee on crude oil and petroleum products. This is an idea which looks very attractive on the surface to those attempting to reduce the federal deficit. But as previous administrations have discovered, import fees of the type being discussed are bad economic policy, bad energy policy, bad foreign policy and bad regulatory policy. It is finally time to pronounce the last rites over an oil import fee and proceed to the greater problem at hand - that of reducing the massive federal deficit our country faces.

Let me describe specifically why independent marketers are so adamantly opposed to oil import fees.

Within the last 15 months, since gasoline decontrol, some 800 independent small business petroleum marketing companies have gone out of business. This is partially because competitive pressures in the marketplace have kept margins razor thin and partially because of the generally deteriorating economy. During the last two years fully 40 percent of our national membership has operated with negative cash flows. At present, literally, six thousand independent small business marketers are "hanging by their fingernails" financially. They do not ask for nor do they want any special consideration; they are satisfied so long as their fate is determined by the marketplace. They are unprepared, however, to cope with or accept an additional burden placed on their backs by the federal government which could serve to bring thousands of these small businesses tumbling down.

An oil import fee will increase the cash flow burden for marketers; will drive up inventory costs, thus increasing the demand for money placing further upward pressure on interest rates; and will place marketers at a competitive disadvantage with their prime competitors -- the major integrated oil companies and public utilities. In order for an import fee to be palatable, one is forced to ignore these economic consequences and seize upon the only argument that no one will dispute - an import fee raises a lot of money. This is gross shortsightedness.

Proponents of the import fee point to the urgent need to reduce the federal deficit in order to bring down high interest rates. NOJC questions this logic. According to a Congressional Budget Office (CBO) study, an import fee would be less successful in lowering interest rates than other measures. This is because a fee raises not only the price of the commodity but also the demand for money to purchase the product. As I indicated earlier, this is certainly true in the petroleum industry. An increased demand for money could put upward pressure on interest rates.

Proponents of the fee ignore its discriminatory nature. A \$5-per-barrel fee would extract from \$20 to \$30 billion from consumers and transfer it to producers and the government. Rural, low-income, and heating oil households would be affected to a greater degree than other consumers. These groups spend a greater proportion of their income on petroleum products. An import fee betrays also those consumers who have responded to higher prices through conservation. In many areas, consumers have taken as many conservation steps as possible given their location and income. The effect of conservation has been lower prices for petroleum products. Now these consumers are punished by the government increasing the price of oil.

For marketers, the result will be economic chaos in the rural and agricultural regions of this country, where they supply a substantial portion of all the fuels used. In the Northeast and Midwest where these independent marketers sell home heating oil the disastrous results will become more apparent as we enter the 1982-1983 winter heating season.

Proponents of the fee ignore the anti-competitive situation which will evolve. In the gasoline marketplace, independent small business marketers must compete with large integrated refiner-marketers, with independent and small refiner-marketers and with one another. Those independents who receive their supplies of products from refiners who import crude oil or products will be placed at a significant competitive disadvantage as their prices will be substantially higher than competitors with domestic crude oil reserves. Even if domestic crude rises at a roughly equivalent rate, the gasoline marketplace will be the scene of wide price disparities and regional differences injurious to thousands of independent competitors. The first to go will be small service station dealers, followed by independent marketers and then by smaller refiners dependent upon foreign crude. The total effect will be devastating to competition and drive consumer prices upward.

In the home heating oil marketplace, independent small business marketers must compete with the gas utilities whose customers continue to benefit from prices which are constrained by government regulations from reaching free market levels. Heating oil users who have payed a decontrolled price for several years are again penalized. This is especially ironic at a time heating oil prices have been decreasing. An import fee will trigger more conversions from oil to gas as a home fuel and devastate thousands of small business companies in the Northeast and Midwest all to the benefit of the local monopoly - the utility company.

Proponents ignore the general inefficiency of the fee as a revenue enhancer. Net federal revenues from an oil import fee would be 27 percent less than the gross federal revenues; due to this "leakage" the fee would have to be higher than alternative revenue enhancers. More revenues and less inflation would result from other tax alternatives. Further, since petroleum imports account for only one-fourth of U.S. consumption; the windfall profits tax would recapture only some 40-50 percent of the net revenues from the three-fourths of oil produced from domestic sources. Domestic producers of petroleum would receive a windfall as the price of U.S. crude rises significantly to the imported oil price; yet only a portion of these "windfall" increases would be collected by the federal government. These producers are already amply rewarded by the marketplace.

An import fee begs for a cumbersome regulatory structure to deal with the inequities that will result. Exemptions are sure to be sought and a new entitlement system is not outside the realm of possibility. It would seem that the same or a similar regulatory apparatus would need be in place to hold prices \$5 over the market as it would to try to hold prices \$5 under the market.

In summary, the fee is discriminatory, anti-competitive and inefficient at the very least. Such a fee imposed just as the domestic petroleum market has seen a return to competition, falling prices, and decreases in the rate of inflation would be devastating not only to marketers but to the millions of consumers they serve. Our opposition to the fee is in no way an indication of NOJC's lack of desire to reduce the federal deficit. The huge deficit has itself generated chaos in the marketplace. Some estimates indicate that as much as 60 percent of small businesses' operating profits and 45 percent of their cash flow in 1981 were eaten up by interest rates. This is an intolerable situation which must be addressed, but an import fee most assuredly is not the answer.

NOJC also wishes to commend the Chairman and his colleagues who have joined the efforts to fight the imposition of the fee and to express our thanks for letting us appear before you today.

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MEMBERS OF THE NATIONAL OIL JOBBERS COUNCIL

NOJC represents these member associations:

Alabama Petroleum Marketers Association
 Arizona Oil Marketers Association
 Arkansas Oil Marketers Association, Inc.
 California Independent Oil Marketers Association
 Colorado Petroleum Marketers Association
 Independent Connecticut Petroleum Association
 Delaware Petroleum Marketers Association
 Florida Petroleum Marketers Association
 Georgia Oilmen's Association
 Idaho Oil Marketers Association
 Indiana Oil Marketers Association, Inc.
 Intermountain Oil Marketers Association
 Iowa Independent Oil Jobbers Association
 Kansas Oil Marketers Association
 Kentucky Petroleum Marketers Association
 Louisiana Oil Marketers Association
 Maine Oil Dealers Association
 Michigan Petroleum Association
 Mid Atlantic Petroleum Distributors Association, Inc.
 Mississippi Petroleum Marketers Association
 Missouri Oil Jobbers Association
 Montana Chapter, Intermountain Oil Marketers Association
 Nebraska Petroleum Marketers, Inc.
 Independent Oil Men's Association of New England
 Better Home Heat Council of New Hampshire
 Fuel Merchants Association of New Jersey
 New Mexico Petroleum Marketers
 Empire State Petroleum Association
 North Carolina Oil Jobbers Association
 Ohio Petroleum Marketers Association
 Oklahoma Oil Marketers Association
 Oregon Oil Jobbers Association
 Pennsylvania Petroleum Association
 South Carolina Oil Jobbers Association
 South Dakota Independent Oilmen's Association
 Tennessee Oil Marketers Association
 Texas Oil Marketers Association
 Virginia Petroleum Jobbers Association
 Washington Oil Marketers Association
 West Virginia Oil Jobbers-Distributors Association
 Oil Jobbers of Wisconsin, Inc.
 Wyoming Petroleum Marketers Association

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 Washington, D.C. 20006

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Mr. FRANK. Thank you, Mr. Chisholm.

Checking over the powers the chairman has passed to me, I think passing last rites is not one of those.

I recognize Mr. Van Arsdall.

**STATEMENT OF R. THOMAS VAN ARSDALL, VICE PRESIDENT,
ENERGY RESOURCES, NATIONAL COUNCIL OF FARMER COOP-
ERATIVES**

Mr. VAN ARSDALL. Thank you.

I am Tom Van Arsdall. I am vice president of energy resources with the National Council of Farmer Cooperatives. The national council is pleased to have the opportunity to appear before this subcommittee to discuss the issue of an oil import fee, and particularly from our perspective, the effects of such a fee on agriculture in rural America.

The National Council of Farmer Cooperatives is a nationwide association of cooperative businesses which are owned and controlled by farmers. The principal purpose of these cooperatives is to enhance the availability of the members' farm operations. Among these cooperatives are supply cooperatives which refine and market petroleum products in more than 40 States and supply about 45 percent of all on farm fuel and a large portion of rural needs.

Cooperatives are unique in the petroleum industry in that consumers of the product own and control the system. As a result, our policies encompass considerations from the wellhead through and including the end user.

The national council must register strong opposition to any imposition of an oil import fee as a means of raising revenues to offset the growing Federal deficit. We believe that for a number of reasons the negative aspects of an oil import fee far outweigh any perceived benefits.

Now, a lot has been said about the impacts on the Northeast. While we certainly concur about the seriousness of this dimension, we would like to dwell somewhat on the national negative impacts on a key segment of our economy, and that is U.S. agriculture.

I had occasion to drive over the heart of the Midwest in the last couple of days from my home State of Illinois through Indiana and Ohio. Everywhere I went the farmers were out there not only during the day, but into the night preparing those fields for planting. They use a lot of diesel fuel, a lot of gasoline. This fuel costs them a lot of money. I need not tell Congressman Hiler and other members of the subcommittee the problems that the American farmer is facing right now.

The bottom line for agriculture is that a \$5 per barrel oil import fee would increase farmers' petroleum fuel cost for business operations alone by about \$1 billion annually. Farming is already depressed to the 1930's level. If it is reduced another 8 percent by an oil import fee, many farmers as price takers may find it exceedingly difficult to stay in business, with untold ramifications for our food system. This is simply unacceptable.

Farmers and their rural neighbors will also suffer as consumers in everyday life. Other inputs that the farmer relies heavily upon, such as fertilizer, will increase in cost considerably over the longer

term, particularly as natural gas and other fuels follow the import fee generated price increase.

We are also concerned that the rural petroleum system could be devastated by the many distortions generated by the artificial windfall that import fees would provide refiners who are rich in domestic crude oil. We don't want to see a return to the regulatory morass that could accompany efforts to offset these distortions.

Farmers will continue to be extremely vulnerable to future disruptions with severe shortages likely to occur in rural areas.

Declining fuel prices cannot be used as partial justification for an oil import fee. Farmers and other hardpressed consumers are finally enjoying brief relief from rising energy prices. We certainly don't need an oil import fee to wipe out this one bit of good news.

In addition, volatile world events could lead to another disruption and price hike at any time. I have read recently that our domestic inventories, both from the refining sector and among users, have returned to minimum levels due to the high interest rates which make it economically infeasible to maintain inventories at a higher level. These inventories are approaching the low levels they were at just before the Iranian revolution.

Now, another witness addressed the oil import fee with regard to emergency preparedness. We share that witness' concern. But we disagree in terms of the approaches that might be used to address emergency preparedness.

There was discussion about the market setting the price, supply and demand factors. History over the last decade has shown that disruptions have established new price plateaus, not the marketplace. Perhaps a more appropriate question is the following: If we have another disruption and oil prices double again, what do you do with the oil import fee then? Do you keep it on or drop it?

So far, the administration has consistently stated its commitment to letting the marketplace determine energy prices. This was one of the reasons given for the Presidential veto of S. 1503, the Standby Petroleum Allocation Act of 1982, a move which was deeply disappointing to the agricultural community.

Imposition of an oil import fee would signal a new dual policy which would encourage upward price adjustments through market events, both in normal times and during disruptions, while countering downward energy price moves by imposing taxes. Last year the administration specifically rejected an oil import fee as an energy policy option. Any move toward an oil import fee now would be a sharp reversal in policy.

In conclusion, we believe an oil import fee would be inflationary, anticompetitive, and unfair. Increases in petroleum costs would be felt throughout the economy, and would clearly exacerbate the current recession.

The structure of the domestic petroleum industry would be artificially distorted with some refiners gaining a competitive edge over others, with long-term adverse consequences for petroleum users. And it would be extremely inequitable and concentrate the adverse consequences of meeting a general revenue need upon one segment of society—consumers of petroleum products, in particular, farmers and home heating oil customers, who are least able to adjust.

We appreciate the opportunity to testify today, and we would be pleased to respond to any questions.
[Mr. Van Arsdall's prepared statement follows:]

Statement of
R. Thomas Van Arsdall
Vice President, Energy Resources
National Council of Farmer Cooperatives

Mr. Chairman and Members of the Committee:

My name is R. Thomas Van Arsdall, Vice President, Energy Resources, of the National Council of Farmer Cooperatives. The National Council is pleased to have the opportunity to appear before this Subcommittee to discuss the issue of an oil import fee and particularly, from our perspective, the effects of such a fee on agriculture and rural America.

The National Council of Farmer Cooperatives is a nationwide association of cooperative businesses which are owned and controlled by farmers. Its membership includes 120 regional marketing and farm supply cooperatives, the 37 banks of the cooperative Farm Credit System, and 31 state councils of farmer cooperatives. National Council members handle practically every type of agricultural commodity produced in the United States, market these commodities domestically and around the world, and furnish production supplies and credit to their farmer members and patrons. Two-thirds of United States farmers are affiliated with one or more cooperatives. The National Council represents about 90 percent of the more than 6,400 farmer cooperatives in the nation, with a combined membership of nearly 2 million farmers.

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Among the cooperatives the National Council represents are supply cooperatives which own and operate 7 efficient refineries which have an aggregate production capacity of about 330,000 barrels per day, and whose yields of gasoline, diesel fuel and heating oil amount to approximately 85 to 90 percent of their refined products. While this represents only 2.5 percent of United States refining capacity, cooperatives market petroleum products in more than 40 states and currently supply about 45 percent of all on-farm fuel and a large portion of rural needs.

The National Council of Farmer Cooperatives would like to register strong opposition to the imposition of an oil import fee, as a means of raising revenues to offset the growing federal deficit. We certainly support Congressional and Administration efforts in the search for both cost-saving and revenue-raising alternatives toward this end. However, we believe that for a number of reasons the negative aspects of an oil import fee far outweigh any perceived benefits.

An oil import fee would unfairly place the burden of fulfilling a general need for increased tax revenues upon one segment of society, namely the consumers of petroleum products. A \$5-per-barrel fee would, at a minimum, increase the cost of a gallon of gasoline--or home heating oil--by 12¢. This tax would be regressive and would tend to impact most heavily those least able to afford it.

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-3-

An oil import fee would be very inflationary, hurting agriculture and the entire economy. We estimate that on an annual basis a \$5-per-barrel import fee would increase farmers' fuel costs by about \$1 billion, thereby reducing net farm income by 5 to 8 percent. Currently, net farm income levels are forecast to be the lowest since the Great Depression. Estimates range from \$13 to \$18 billion, as much as a 50 percent decrease from the already depressed 1981 level of \$23 billion. Given the serious state of the farm economy presently, farmers can ill afford an additional shock of this magnitude. As price takers, farmers cannot pass such increased costs forward. Even if they could, consumers don't need the double shock of import fees reflected in higher food prices.

An oil import fee also would generate severe distortions in the domestic petroleum industry and would jeopardize the viability of the rural petroleum system. Farmer cooperatives and other independent refiners supply between two-thirds and three-quarters of the demand for petroleum products in the agricultural market. A number of major oil companies are continuing to withdraw from these less profitable markets. Under the existing petroleum system, cooperative and other independent refiners directly own only a small portion of their crude oil requirements. They are heavily reliant on domestic crude oil contracts and imported crude oil to fulfill their needs. To the extent that refiners rich in domestic crude oil choose to

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employ part of the import fee cost advantage to gain a competitive edge in the presently depressed petroleum market, the viability and integrity of the rural petroleum system would be jeopardized. Even a small economic disadvantage could be devastating.

Alternatively, the after-tax economic benefits of an oil import fee which accrue to domestic oil might be utilized for increased exploration and production. However, this artificial advantage would accrue solely to the benefit of those refiners already rich in domestic crude oil. Other domestic refiners would have even less capital to continue developing their own secure domestic crude oil supplies. Accordingly, their customers would remain more vulnerable to disruptions, with severe regional shortages more likely in rural areas.

Some have argued that declining fuel prices would at least partially offset an import fee, and thus the full effects would not be apparent to end users. However, farmers and other consumers are finally receiving a small bit of much needed relief in the form of declining fuel prices. They certainly do not need an oil import fee to negate this modest cost saving.

So far, the Administration has consistently stated its commitment to letting the marketplace determine energy prices. This was one of the reasons given for the Presidential veto of

S. 1503, the Standby Petroleum Allocation Act of 1982. Imposition of an import fee would signal a new dual policy which would encourage upward price adjustments through market events, both in normal times and during disruptions, while countering downward energy price moves by imposing taxes. Thus, an oil import fee is grossly inconsistent with the Administration's commitment to a free market.

Another area of concern is that the inequities of an import fee would be increased by probable attempts to exempt certain oil imports. Should petroleum product imports be exempted a major artificial distortion in the domestic petroleum industry would result. This loophole would stimulate a dramatic shift from crude oil to petroleum product imports. While this development might temporarily benefit consumers, it would wreak havoc upon a domestic refining sector already struggling through major adjustment in the face of reduced demand. Domestic refining capacity would essentially be "exported," and the revenues generated by the fee program would be significantly reduced. The Nation's ability to respond to oil supply disruptions would also be sharply restricted as a result.

In conclusion, Mr. Chairman, we believe an oil import fee would be inflationary, anti-competitive, and unfair. Increases in petroleum costs would be felt throughout the

-6-

economy and would clearly exacerbate the current recession. The structure of the domestic petroleum industry would be artificially distorted with some refiners gaining a competitive edge over others. And, it would be extremely unfair to concentrate the adverse consequences of meeting a general need upon one segment of society--consumers of petroleum products, in particular farmers and home heating oil customers who are least able to adjust.

Mr. Chairman, we appreciate the opportunity to testify today, and would be pleased to respond to any questions that you or other Members of the Subcommittee might have.

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Mr. FRANK. Thank you.
The gentleman from Indiana.
Mr. HILER. Thank you.

Mr. Van Arsdall, I would say when you were driving through Indiana, you probably drove through a mixture of farmers out late at night going over the soil and running pumps to get the water out of the soil. They have had a significant amount of water in the last month.

Mr. Blum, do you think that it makes rational energy policy to impose a \$5 import fee on petroleum, while at the same time, keeping controls on the price of natural gas?

Mr. BLUM. I don't think so. I think what you will do is create more insanity in the switching area that doesn't lead to conservation, doesn't help anyone. What you will do in the end is create an enormous windfall to natural gas producers at the point where the Natural Gas Policy Act does finally expire.

I think, too, that the windfall for the decontrol of natural gas in the short run, will be exorbitant.

Mr. HILER. Mr. Chisholm, I presume your people would object a great deal to imposing a \$5 fee without doing something to natural gas prices?

Mr. CHISHOLM. There is no question. We think from a revenue standpoint it makes more sense to deregulate natural gas, and you can derive those corporate profits that producers receive for allowing gas prices to rise to free market levels, that would be a source of revenue, and there would be a potential windfall you can tax as well.

Mr. HILER. And in terms of a national energy policy, if we were tremendously interested in having the market determine the allocation and production of energy, that would be a far more rational policy to pursue?

Mr. CHISHOLM. There is no question in our mind about that.

Mr. HILER. Mr. Chairman, it has been a hard time today finding people in favor of this \$5 fee.

Mr. FRANK. Let me ask all of you gentlemen—in his statement, Mr. Montgomery says, in his conclusion, "We recognize that energy policy considerations are only one part of the decision on our oil imports fee." And he concedes "who will benefit from and who will pay the tax also matters."

This is a statement I would like your collective opinions on, because you have all been very experienced in this area: "It remains a matter for political judgment whether adverse distributional consequences can be offset through adjusting other taxes or programs."

In other words, Mr. Montgomery concedes there would be adverse distributional consequences of the \$5 or more oil import fee, and he says it is a political judgment whether or not these can be offset through adjusting other taxes or programs. I would like your comments on whether you think the conceded adverse distributional effects would be offset, and how much it would cost and what kind of process that would take?

Mr. BLUM. My first reaction is that the first thing that would happen would be the establishment of a series of offsetting programs to take care of all of the people who have been injured by

the fee that has just been imposed, and that has been the track record. You will wind up with increased need for fuel assistance, increased assistance to certain groups that are disadvantaged, increased regional perhaps exceptions for New England, exceptions for one group or another that are disadvantaged.

I would hope if it happened, we marketers who were disadvantaged would be in talking to you about some form of relief. The fact of the matter is that every time this business has come up, there has had to be some kind of concomitant bureaucracy that administered relief for the people that needed relief.

Mr. FRANK. You think it might interfere with plans to dismantle the Energy Department?

Mr. BLUM. That has been an argument we have made again and again.

Mr. BUCKLEY. You would certainly want to help people like the chemical industry, who use oil for 30 percent of their raw materials, both as a raw material for making things and for energy, or else lose enormously in your balance of payments. And if you help the chemical industry, which is a balance of payments winner, there may well be other manufacturing firms that will just be shut out of the world market that you will want to help.

Congressman Conte earlier today said that he had been approached by members of the budget discussion group saying "Will you get off this thing if we will agree to give you a home heating oil exception?"

Yes; I think there will be a lot of exceptions. Small refiners that import all of their crude from abroad will be at a disadvantage to larger refiners with their own domestic crude. We will reinvent the wheel we just thought we got rid of.

Mr. FRANK. In addition to the social equity consequences, you are saying there are adverse competitive effects here. The differential use of imported versus nonimported oil so permeates the economy that once you would inject this import fee, it would be virtually impossible ever to put things right again.

Mr. Chisholm.

Mr. CHISHOLM. I think Mr. Buckley and Mr. Blum's point are right on target. If you remember the 10-cent-a-gallon gasoline fee President Carter tried to proposed in 1979, part of that was to try to address the political consequences of the New England block. And the impact on home heating oil—there was supposed to be an exemption from home heating oil. But for that to be effective, you had to put controls back on home heating oil in some form to determine whether the fee had been passed through by refiners. There was no way to do it any other way. And we just see disastrous distributional effects in all segments of society.

It is going to clearly be inequitable, and the bureaucracies in the time that it would take to set that type of system up simply is not worth the revenue you are going to gain from an import fee.

Mr. VAN ARSDALL. I don't think the American farmer would be left out without getting his 2 or 3 cents in, particularly right now. If you recall the spring of 1979, when he was unable to get his diesel fuel for spring planting, a fuel not under any controls, the Government reimposed allocation controls. According to Department of Agriculture testimony last spring, a lot of farmers would

not have gotten their crops in had the Government not stepped back in.

The issue of whether the farmer gets his fuel is a much larger question than whether he gets his crops in. It is how much is food going to cost the American consumer if he doesn't. The best thing that can happen to a farmer is for his neighbors to have a bad year and he a good year.

But regarding their import fee, I think a key feature to recognize right now is that that issue has been debated a number of times over the last 10 to 15 years, and each time once the merits and demerits were addressed, it was abandoned as a bad idea.

I think the negative aspects in the current environment are even more painful than we have ever seen them before, because there is so little flexibility left in the American economy to respond to an adverse impact. The farmer is down—even though he is still optimistic—down to his last drop, facing a cost/price squeeze that has a lot of farmers in desperate straits. This fee could do far more damage now in the present economy to the farmer and other sectors of the economy than perhaps in other times.

Mr. FRANK. I think what you point out—this was addressed in previous years—when the oil import situation was more of a problem. It is ironic now we are seeing this as a revenue raising measure. People are coming forward with it because it is a revenue raising measure. The tax bill—with every loophole everybody ever thought of—to have people coming forward now with this particular proposal, justifying it mostly for its revenue impact, is extraordinary, and I think this testimony this morning—I was able to hear some parts of it—it is so clear that the energy distorting impact of this, the problems of competition, the problems of equity, the problems of regional competition, so far outweigh any contribution this could make to the revenue problem that it is really hard to see that it would be put forth seriously.

It is hard to understand why it is coming forward to us over the transom, and under the door. They ring the bell, you open the door, and there is the oil import tax fee and a little note saying adopt me and you will reduce the deficit. But there is no fathers and no mothers.

Mr. BLUM. Mr. Chairman, back in, I guess it was June, the Aspen Institute held a session at Wye Island to discuss how we got an \$88 billion Synfuels Corporation at the end of the Carter administration. The question on the table was why did Government respond to gasoline lines in Los Angeles by creating the Synfuels Corporation that might produce its first fuel 10 years out at enormous cost.

And the answer was that there had been an idea that had been kicking around for about 12 years. There had never been a political window through which the people who had the idea could push it. And suddenly there was a crisis and everybody needed an idea, so out came this Synfuels Corporation, and that was the idea of the hour. So it worked its way through Congress.

I think this import fee is very much the same thing. It is an idea that keeps cropping up everytime somebody needs to balance the budget. And no matter how awful the consequences and no matter

how many times we have told them the consequences are awful, and no matter what the experience, out it comes.

Mr. FRANK. I appreciate it. I have been here only 15 months, but I must say, this is a broader representation from consumers, industry, agriculture. There has been tremendously impressive consensus of people directly affected on this, and I think this hearing will have made a contribution to the fight which my colleague, Mr. Conte, has been leading.

If there are no further comments, I thank you all, and the hearing is adjourned.

[Whereupon, at 11:40 a.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]

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188

APPENDIX

STATEMENT SUBMITTED FOR THE RECORD

American Farm Bureau Federation



WASHINGTON OFFICE
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April 27, 1982

Honorable Toby Moffett, Chairman
Environment, Energy and Natural
Resources Subcommittee
House Government Operations Committee
B 371-B Rayburn House Office Building
Washington, DC 20515

Dear Mr. Chairman:

Farm Bureau opposes the \$5 per barrel oil import fee as a means to increase revenue to help offset the growing federal budget deficit. Farm Bureau opposes in principle the concept of balancing the federal budget through added revenues produced by increased or new taxes, rather than cutting expenditures.

Furthermore, America's farmers simply cannot afford the added burden of an oil import fee, or any other tax on energy. An oil import fee would make an already critical farm income situation even worse. Depressed commodity prices and increased production costs have reduced net farm income for the last three years.

Farms and rural areas would have to pay a disproportionate share of the import fee. Almost 75 percent of the farm and rural fuel requirements are served by cooperative and independent refiners that must rely upon foreign imports for the bulk of their crude oil feedstocks.

The cost of the import fee would have to be absorbed by the farmer himself. Farmers are price takers, not setters, when selling their commodities. Unlike some businesses, farmers cannot simply add production cost increases on to the price of their products.

We will appreciate your consideration of our views and ask that they be included in the record of the Subcommittee's April 27, 1982 hearing.

Sincerely,

John C. Datt
Secretary and Director
National Affairs Division

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cc: Subcommittee Members

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